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REVES v. ERNST & YOUNG: THE ELIMINATION OF PROFESSIONAL LIABILITY UNDER RICO

In 1970, Congress passed the Racketeer Influenced and Corrupt Organizations Act ("RICO"),¹ as Title IX of the Organized Crime Control Act.² Prompted by congressional findings that the fraudulent activity of organized crime permeated the American economy and victimized innocent investors,³ Congress enacted RICO to combat the infiltration of le-

1. 18 U.S.C. §§ 1961-68 (1988).

2. 115 CONG. REC. 39,906 (1969). The Organized Crime Control Act was a "broad-based reform bill covering such areas as grand juries, immunity, contempt, false statements, depositions, and sentencing for dangerous special offenders." G. Robert Blakey & Brian Gettings, *Racketeer Influenced and Corrupt Organizations (RICO): Basic Concepts-Criminal and Civil Remedies*, 53 TEMP. L.Q. 1010, 1017 (1980) (discussing the legislative initiatives leading to RICO's enactment) (footnotes omitted).

3. Organized Crime Control Act of 1970, Pub. L. No. 91-452, 84 Stat. 922, 941-48 (1970) (codified at 18 U.S.C. § 18 (1988)). The Statement of Findings and Purpose provides:

The Congress finds that (1) organized crime in the United States is a highly sophisticated, diversified, and widespread activity that annually drains billions of dollars from America's economy by unlawful conduct and the illegal use of force, fraud, and corruption; (2) organized crime derives a major portion of its power through money obtained from such illegal endeavors as syndicated gambling, loan sharking, the theft and fencing of property, the importation and distribution of narcotics and other dangerous drugs, and other forms of social exploitation; (3) this money and power are increasingly used to infiltrate and corrupt legitimate business and labor unions and to subvert and corrupt our democratic processes; (4) organized crime activities in the United States weaken the stability of the Nation's economic system, harm innocent investors and competing organizations, interfere with free competition, seriously burden interstate and foreign commerce, threaten the domestic security, and undermine the general welfare of the Nation and its citizens; and (5) organized crime continues to grow because of defects in the evidence-gathering process of the law inhibiting the development of the legally admissible evidence necessary to bring criminal and other sanctions or remedies to bear on the unlawful activities of those engaged in organized crime and because the sanctions and remedies available to the Government are unnecessarily limited in scope and impact.

It is the purpose of this Act to seek the eradication of organized crime in the United States by strengthening the legal tools in the evidence-gathering process, by establishing new penal prohibitions, and by providing enhanced sanctions and new remedies to deal with the unlawful activities of those engaged in organized crime.

Id. at 922-23.

gitimate business by organized crime.⁴ To achieve this goal, Congress authorized the imposition of substantial criminal and civil penalties against any person⁵ violating the statute's provisions.⁶

Following its enactment, RICO was used primarily in criminal prosecutions,⁷ but infrequently used by private plaintiffs in the civil context.⁸ In

4. See, e.g., *United States v. Turkette*, 452 U.S. 576, 591 (1981) (stating that the "legislative history forcefully supports the view that the major purpose of [RICO] is to address the infiltration of legitimate business by organized crime"); Blakey & Gettings, *supra* note 2, at 1014-16 (discussing the significance of the infiltration problem); Gerard E. Lynch, *RICO: The Crime of Being a Criminal, Parts I & II*, 87 COLUM. L. REV. 661, 662 (1987) (stating that "Congress viewed RICO principally as a tool for attacking the specific problem of infiltration of legitimate business by organized criminal syndicates."). See *infra* notes 73-79 (describing RICO's substantive provisions which are designed to prevent the infiltration of organized crime into legitimate businesses).

5. A "person" is "any individual or entity capable of holding a legal or beneficial interest in property." 18 U.S.C. § 1961(3) (1988).

6. 18 U.S.C. §§ 1963-64 (1988). Section 1963(a) sets forth the criminal penalties that may be imposed against defendants found guilty of violating the Act. *Id.* § 1963(a). Criminal RICO defendants may be subject to a fine not exceeding \$25,000, up to twenty years imprisonment, and the forfeiture of any profits or property that they have acquired as a result of racketeering activity. *Id.* Section 1964(a)-(c) sets forth the civil penalties which provide for divestment, imposition of restrictions, orders of dissolutions, and treble damages. *Id.* § 1964(a)-(c). See *infra* notes 81-82 (providing the text of the provision and discussing RICO's forfeiture penalty); *infra* notes 83-86 (discussing the significance of RICO's provision for treble damage recovery by a private plaintiff), and accompanying text.

7. Blakey & Gettings, *supra* note 2, at 1011-12 (describing how prosecutors rarely used RICO initially, but by the 1980s they were using the Act in a wide range of federal prosecutions for organized crime, white-collar crime, and a variety of violent offenses); see also Lynch, *supra* note 4, at 695. Professor Lynch notes that only four RICO indictments had been considered in reported federal appellate court opinions throughout 1975, demonstrating prosecutors' initial tendency to use RICO cautiously. *Id.* Professor Lynch explained that these early uses of RICO "involv[ed] classic 'racketeering' schemes that directly preyed upon legitimate economic activity, or entry into legitimate business by criminal means." *Id.* at 696 (footnote omitted).

8. G. Robert Blakey, *Forward, Symposium, Law and the Continuing Enterprise: Perspectives on RICO*, 65 NOTRE DAME L. REV. 873, 881 (1990) (indicating that private plaintiffs did not use civil RICO until about 1975); Blakey & Gettings, *supra* note 2, at 1048 (concluding that prior to 1980, criminal prosecutions dominated the use of RICO and that private plaintiffs had not yet capitalized on the promise of civil RICO); Susan Getzendanner, *Judicial "Pruning" of "Garden Variety Fraud" Civil RICO Cases Does Not Work: It's Time for Congress to Act*, 43 VAND. L. REV. 673, 678 (1990) (stating that "civil RICO percolated for several years before coming to life"). Section 1964(a)-(c) contains the civil counterpart to criminal RICO. 18 U.S.C. § 1964 (1988). A civil RICO action may be brought by either the Attorney General on behalf of the government or a private plaintiff for injuries sustained as a result of a RICO violation. *Id.* This Note will not examine the use of civil RICO by the government, but will focus on the use of RICO by private plaintiffs invoking section 1962(c). See ORGANIZED CRIME & RACKETEERING SEC., U.S. DEP'T OF JUSTICE, *CIVIL RICO: A MANUAL FOR FEDERAL PROSECUTORS* (1988) (providing a detailed discussion of the procedures, frequency, and success of the government's use of civil RICO).

the 1980s, however, RICO's use in the civil context dramatically increased.⁹ Despite RICO's intent to eliminate organized crime,¹⁰ or "known mobsters,"¹¹ private plaintiffs successfully used the statute to attack legitimate business.¹² RICO's "evolutionary application" to situations that, arguably, were not contemplated by Congress has had a significant societal impact.¹³ Today, civil RICO is used primarily by pri-

9. A.B.A., SEC. CORP. BANKING & BUSINESS LAW, REPORT OF THE AD HOC CIVIL RICO TASK FORCE 57 (1985) [hereinafter TASK FORCE REPORT]. The Civil RICO Task Force demonstrated the dramatic change in the use of civil RICO from its "initial dormancy" to its "increased utilization" when it charted 270 district court RICO cases prior to 1985. *Id.* The Report's statistics indicated that 3% of the cases were decided prior to 1980; 2% were decided in 1980; 7% were decided in 1981; 13% were decided in 1982; 33% were decided in 1983; and 43% were decided in 1984. *Id.* at 53a.

10. See Philip A. Lacovara & Geoffrey F. Aronow, *The Legal Shakedown of Legitimate Business People: The Runaway Provisions of Private Civil RICO*, 21 NEW ENG. L. REV. 1, 8-9 (1984-85). Lacovara and Aronow recognize that Congress specifically intended RICO as a mechanism to proscribe the unlawful activities of individuals engaged in organized crime. *Id.* Furthermore, the authors argue that Congress did not intend to displace this limited purpose by incorporating civil enforcement mechanisms. *Id.* at 9. They contend that "[a]t no time did any supporter of the bills suggest that the private civil remedy was intended for use *against* legitimate business people, corporations, or partnerships of licensed professionals, nor was it to be used in commercial disputes having nothing whatever to do with the [original limited intent]." *Id.* at 9 (emphasis in original); see also *supra* note 3 (providing the Statement of Findings and Purpose of the Organized Crime Control Act). But see Blakey, *supra* note 8, at 874 (stating that Congress did not intend to limit RICO's scope solely to "the activities of traditional Mafia families").

11. See DAVID B. SMITH & TERRANCE G. REED, CIVIL RICO § 1-5 (1993) (noting that RICO's application has not been confined to "known mobsters"). Compare Blakey & Gettings, *supra* note 2, at 1013-14 (arguing that Congress did not intend to confine RICO's application to this class of criminals). Professor Blakey, one of RICO's authors, defines organized criminal behavior or "enterprise criminality" to include simple political corruption, sophisticated white collar criminal schemes, and traditional Mafia type endeavors. *Id.* at 1014.

12. See, e.g., Michael Goldsmith, *Civil RICO Reform: The Basis for Compromise*, 71 MINN. L. REV. 827, 829 (1987) (citing the concern that RICO's use against legitimate businesses has generated efforts to reform the statute); Jay Kelly Wright, *Why are Professionals Worried About RICO?*, 65 NOTRE DAME L. REV. 983, 984 (1990); Adam F. Ingber, Note, *10b-5 or Not 10b-5?: Are the Current Efforts to Reform Securities Litigation Misguided?*, 61 FORDHAM L. REV. S351, 374 (1993) (indicating that civil RICO is used to target legitimate business more frequently than organized crime); see also *infra* note 13 (discussing RICO's increased utilization by private plaintiffs to target garden variety fraud and ordinary commercial disputes among legitimate businesses).

13. Terrance G. Reed, *The Defense Case for RICO Reform*, 43 VAND. L. REV. 691, 692 n.6 (1990) (citing examples of RICO's evolutionary application: employment grievance claims, attorney-client disputes, insurance claims, and landlord-tenant litigation). As a result of civil RICO's expansive evolution, RICO claims are added to virtually all contract claims and allegations of common law fraud against legitimate businesses. Representative Rick Boucher explained that "all that is needed to convert a simple contract dispute into a civil RICO case is the allegation that there was a contract and the additional allegation that either the mails or the telephones were used more than once in either forming or breaching the contract." Michael Goldsmith & Mark Jay Linderman, *Civil RICO Reform: The Gate-*

vate plaintiffs to target garden-variety fraud and ordinary commercial disputes.¹⁴ As a result, courts and scholars are attacking RICO,¹⁵ arguing that it has evolved beyond its intended statutory reach.¹⁶ Despite this

keeper Concept, 43 VAND. L. REV. 735, 736 (1990) (citing 132 CONG. REC. H9371 (daily ed. Oct. 8, 1986) (remarks of Representative Rick Boucher, sponsor of 1989 RICO reform legislation)). Moreover, commentators note that failure to include a RICO claim may be grounds for legal malpractice. See, e.g., Ethan M. Posner, Note, *Clarifying a "Pattern" of Confusion: A Multi-Factor Approach to Civil RICO's Pattern Requirement*, 86 MICH. L. REV. 1745, 1770 (1988) (acknowledging that "it is so easy and tempting to allege a RICO claim that counsel may commit malpractice if a RICO claim is not made when the section 1962 statutory elements have been satisfied") (footnote omitted).

14. See TASK FORCE REPORT, *supra* note 9, at 55-56 (reporting that out of the 270 civil RICO actions surveyed, 40% alleged securities fraud, 37% alleged common law fraud in a commercial setting, and only 9% alleged "criminal activity of a type generally associated with professional criminals"); Getzendanner, *supra* note 8, at 679-80 (defining garden-variety fraud in the context of RICO complaints as claims "predicated exclusively on mail or wire fraud, concern[ing] a commercial dispute to which the attorney has added unremarkable fraud allegations"). The author, a former United States District Court Judge in Chicago, discusses several examples of ordinary commercial disputes transformed into civil RICO suits. *Id.* at 673, 679. For example, she cites *Ashland Oil, Inc. v. Arnett*, 875 F.2d 1271 (7th Cir. 1989) (including a RICO claim in an action by a supplier who furnished a purchaser oil in excess of purchaser's credit limit), and *Haroco, Inc. v. American Nat'l Bank & Trust Co.*, 747 F.2d 384, 385 (7th Cir. 1984) (including a RICO claim in an action against a bank for charging an interest rate that was higher than the rate originally agreed upon), *aff'd*, 473 U.S. 606 (1985). See also Goldsmith, *supra* note 12, at 832 (stating that civil RICO suits are "aimed at combatting fraud; relatively few have involved traditional organized crime groups") (footnote omitted).

15. See, e.g., Goldsmith, *supra* note 12, at 829. The author discusses the arguments against RICO and the numerous reform bills that have been generated to limit the scope of the statute. *Id.* He views anti-RICO arguments as expressing "concerns that RICO suits against legitimate businesses both distort[] the congressional intent underlying the statute and afford[] undue opportunity for malicious prosecution." *Id.* (footnote omitted). Moreover, RICO critics argue that the expansive scope of the statute results in extortionate litigation, inducing defendants to enter coercive settlements because of the threat of being labeled a racketeer and the spectre of treble damages. *Id.* at 857. As a result of substantial criticism, numerous RICO reforms have been advocated. See Getzendanner, *supra* note 8, at 674-75. The author recognizes that "[c]ivil RICO is not intrinsically evil" and has facilitated its goal of enabling private plaintiffs to attack patterns of criminality, but "the complaint is that RICO has succeeded too well." *Id.* at 674. The author suggests that the elimination of mail and wire fraud as RICO predicate offenses (except for certain class action suits) will reduce the proliferation of garden variety fraud RICO actions unnecessarily brought into federal court. *Id.* at 675. The author also suggests eliminating securities fraud as a RICO predicate offense. *Id.*; cf. Goldsmith & Linderman, *supra* note 13, at 735 (evaluating proposals to screen civil RICO actions, similar to governmental prosecutorial guidelines); Wright, *supra* note 12, at 995 (eliminating automatic treble damage recovery in civil RICO suits); Ingber, Note, *supra* note 12, at 374 (arguing that RICO reform is preferable to federal securities law reform).

16. The intended scope of the statute is at the heart of the RICO controversy. See, e.g., *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 500 (1985) (stating that "in its private civil version, RICO is evolving into something quite different from the original conception of its enactors"); *id.* at 501 (Marshall, J., dissenting) (arguing that "the civil RICO statute quite simply revolutionizes private litigation; it validates the federalization of broad areas

concern, the statute's broad language and the congressional mandate to interpret RICO liberally¹⁷ prevent the courts from restricting the scope of the statute.¹⁸ Consequently, more individuals are exposed to potential RICO liability and the harsh spectre of treble damages.¹⁹

The expanded application of RICO is particularly relevant to professionals who perform peripheral services for a business entity.²⁰ Peripheral service providers, such as accountants, attorneys, bankers, engineers,

of state common law of frauds, and it approves the displacement of well-established federal remedial provisions. We do not lightly infer a congressional intent to effect such fundamental changes.”); Goldsmith, *supra* note 12, at 828-29 (discussing arguments that the use of RICO to attack legitimate businesses distorts the congressional intent underlying the statute); Lacovara & Aronow, *supra* note 10, at 2-3 (asserting that only a small percentage of private civil RICO claims involve the activities envisioned by the Act's proponents); Robert K. Rasmussen, *Introductory Remarks and a Comment on Civil RICO's Remedial Provisions*, 43 VAND. L. REV. 623, 627 (1990) (stating “[i]t is this civil remedy, coupled with the ingenuity [and artful pleading] of lawyers, that has resulted in the use of RICO in a variety of unexpected situations”); Ingber, Note, *supra* note 12, at 377 (suggesting that an overly broad application of civil RICO exceeds its original congressional intent); Posner, Note, *supra* note 13, at 1769 (stating that “[e]ven though the legislative history suggests that RICO's applicability should be limited to the type of ongoing illegal activity associated with professional criminals, the current scope of civil RICO litigation has gone far beyond this goal”). *But see* Lynch, *supra* note 4, at 661 (suggesting that broad draftsmanship left RICO open to a wide range of applications, but not necessarily unintended applications).

17. Organized Crime Control Act of 1970, Pub. L. No. 91-452, 84 Stat. 922, 947 (codified at 18 U.S.C. § 1961 (1988)). Congress directed that the “provisions of this title shall be liberally construed to effectuate its remedial purposes.” *Id.*

18. *See infra* notes 140-67 and accompanying text (discussing the reluctance of the federal circuits to limit RICO in both civil and criminal cases).

19. *See Sedima*, 473 U.S. at 504 (Marshall, J., dissenting) (arguing that without the presence of a comparable restraint on prosecutorial discretion in the civil context, private “[p]laintiffs, lured by the prospect of treble damages and attorney's fees, have a strong incentive to invoke RICO's provisions whenever they can allege in good faith two instances of mail or wire fraud”); *see also infra* note 83 (providing the text of the private RICO remedy); *infra* notes 85-87 (discussing the treble damages provision).

20. Lacovara & Aronow, *supra* note 10, at 3 (recognizing that private plaintiffs are using RICO to attack professionals, including investment bankers, brokers, and accountants); Wright, *supra* note 12, at 983 (noting that professionals differ from other RICO defendants because they lack a “direct stake in the success of the transaction”); Walter F. McDonough, Note, *Does the Punishment Fit the Crime? How Federal and State Civil RICO Statutes Transform Accountant Liability*, 26 SUFFOLK U. L. REV. 1107, 1107-08 (1992) (discussing the rise of RICO liability for professionals such as “bankers, insurers, directors, lawyers, and accountants,” but arguing that accountants are the primary target). The author also relates one financial analyst's account of the increasing application of RICO to members of the financial industry: “accounting firms that profess to be guilty of nothing worse than regrettable credulity in their client dealings, have increasingly found themselves the targets of the same sort of financial and public-relations abuse that known mobsters must endure.” *Id.* at 1109 n.15.

and experts,²¹ perform peripheral independent services, but lack extensive financial involvement with their clients.²² These individuals are particularly susceptible to a private civil action under RICO because of the preconception that they possess "deep pockets."²³ In fact, they may be the only financially viable parties remaining after a business fails.²⁴ Therefore, peripheral service providers, who are threatened with extortionate litigation, suffer disproportionately from the damages resulting from traditional business fraud.²⁵ Like most RICO defendants, professionals are targeted under section 1962(c)²⁶ based on allegations that they "participated in the conduct of the enterprise's affairs" by providing fi-

21. Wright, *supra* note 12, at 983. The special nature of professionals is not limited to accountants, lawyers, and the like, but can be generalized to a broader class such as experts.

22. *Id.* (describing peripheral service providers as individuals "whose services are a necessary or facilitating ingredient of a business transaction of some type, but who lack a direct stake in the success of the transaction"). See Edward Brodsky, *RICO Liability of Accountants and Lawyers*, N.Y. L.J., Mar. 11, 1992, at 3 (defining a professional in the context of RICO liability as individuals "such as accountants who do nothing more than perform services, albeit fraudulently, but do not otherwise participate in the affairs of the company they represent"); Marcia Coyle, *Back to the Law's Intent: RICO Limits Set for Professionals*, NAT'L L.J., Mar. 15, 1993, at 3 (describing professionals as "lawyers, accountants and other[s] . . . who advise businesses that find themselves in trouble"). This Note will refer to professionals or peripheral service providers in its analysis of whether the class of defendants against whom RICO is used in ordinary commercial fraud cases is an appropriate RICO target. This Note's use of the term "professional" or "peripheral service provider" is confined to the same parameters as Mr. Wright's definition of the term. See Wright, *supra* note 12, at 983.

23. Wright, *supra* note 12, at 984 (arguing that civil RICO's treble damages provision promotes the tendency to perceive professionals as having excessive funds to satisfy legal judgments). Moreover, the author indicates that auditors are the preferred defendants in a RICO action because: (1) they have the appropriate insurance with high limits of liability; (2) accounting firms, organized as a partnership, have deeper pockets to satisfy claims than do officers or directors of a corporation; and (3) fraud is usually excluded from a corporate director's or officer's insurance policy. *Id.* at 992; see also Mark Stephen Poker, *Reaching a Deep Pocket Under the Racketeer Influenced and Corrupt Organizations Act*, 72 MARQ. L. REV. 511, 512 (1989) (asserting that "a RICO suit would not be economically worthwhile, unless the plaintiff had access to a 'deep pocket'").

24. Wright, *supra* note 12, at 991 (noting that, in the case of a failed business, investors frequently rely exclusively on professionals for economic redress); McDonough, Note, *supra* note 20, at 1111 (asserting that because failed businesses do not have insurance available to satisfy a civil judgment for damages, accountants, who are adequately insured, are the defendants of choice in a civil RICO action).

25. Wright, *supra* note 12, at 984-97 (supporting the elimination of treble damages because a professional is exposed to "enormous, potentially indeterminate damages wholly disproportionate[] to the professional's undertaking or conduct"). *Id.* at 984; McDonough, Note, *supra* note 20, at 1112 (stating that the legal system unfairly penalizes accountants in RICO suits because accountants are a more likely target, due to their unsurpassed liability coverage).

26. TASK FORCE REPORT, *supra* note 9, at 57 (estimating that 97% of RICO cases allege a § 1962(c) violation); see also *infra* note 75 (providing the text of § 1962(c)).

nancial or advisory opinions which resulted in fraud.²⁷ The scope of section 1962(c) in this context, however, remained unclear.²⁸

The federal circuit courts inconsistently determined the level of "participation" that section 1962(c) requires to impose RICO liability.²⁹ The Eighth Circuit and the District of Columbia Circuit adopted an "operation or management" test that requires the defendant to have participated in the direction of the enterprise's affairs.³⁰ The Second, Third, Fifth, Sixth, Seventh, Ninth, and Eleventh Circuits, however, interpreted section 1962(c) more expansively³¹ by requiring participation in activities which merely relate to or affect the enterprise.³²

The United States Supreme Court recently sought to reconcile these standards when it considered whether an independent accounting firm that provided fraudulent auditing services must participate in the operation or management of the enterprise itself to be subject to section 1962(c) liability.³³ In *Reves v. Ernst & Young*,³⁴ the Court adopted the Eighth Circuit's operation or management test, and interpreted section 1962(c) to impose liability on individuals participating in and directing the affairs of the business.³⁵ Significantly, the *Reves* decision departs from traditional liberal RICO jurisprudence,³⁶ and adopts an approach

27. Wright, *supra* note 12, at 983 (voicing concern over the application of RICO).

28. See *infra* notes 132-202 (discussing the different legal standards used by the federal circuits to satisfy § 1962(c)).

29. *Yellow Bus Lines, Inc. v. Drivers Local Union 639*, 913 F.2d 948, 952 (D.C. Cir. 1990) (stating that the federal circuit courts "have followed divergent paths and have reached disparate conclusions" on this issue), *cert. denied*, 111 S. Ct. 2839 (1991).

30. See *Yellow Bus Lines*, 913 F.2d at 954; *Bennett v. Berg*, 710 F.2d 1361, 1364 (8th Cir.), *cert. denied*, *Prudential Ins. Co. v. Bennett*, 464 U.S. 1008 (1983); *infra* notes 194-202 (outlining the District of Columbia Circuit's test); *infra* notes 180-93 (outlining the Eighth Circuit's test).

31. See *Overnite Transp. Co. v. Truck Drivers Local 705*, 904 F.2d 391, 394 (7th Cir. 1990); *United States v. Yarbrough*, 852 F.2d 1522, 1544 (9th Cir.), *cert. denied*, 488 U.S. 866 (1988); *Bank of Am. Nat'l Trust & Sav. Ass'n v. Touche Ross & Co.*, 782 F.2d 966, 970 (11th Cir. 1986); *United States v. Cauble*, 706 F.2d 1322, 1332-33 (5th Cir. 1983), *cert. denied*, 465 U.S. 1005 (1985); *United States v. Provenzano*, 688 F.2d 194, 200 (3d Cir.), *cert. denied*, 459 U.S. 1071 (1982); *United States v. Scotto*, 641 F.2d 47, 54 (2d Cir. 1980), *cert. denied*, 452 U.S. 961 (1981).

32. See *supra* note 31 (citing decisions interpreting § 1962(c) more expansively). See *infra* notes 140-57 (outlining the Second, Third, and Ninth Circuit tests); *infra* notes 158-67 (outlining the Fifth, Sixth, and Seventh Circuit tests); *infra* notes 168-76 (outlining the Eleventh Circuit's test).

33. *Reves v. Ernst & Young*, 113 S. Ct. 1163, 1165 (1993).

34. *Id.*

35. *Id.* at 1170.

36. See *infra* notes 93-131 and accompanying text (discussing the Supreme Court's expansive interpretations of RICO).

that restricts both the scope and application of the statute.³⁷ As a result of *Reves*, professionals once targeted by civil RICO claims will fall outside of the statute's scope unless the plaintiff can demonstrate the significance of the professional's role in the fraudulent activity.³⁸

In *Reves*, the Farmer's Cooperative of Arkansas and Oklahoma, Inc. ("the Co-op") sold demand notes in an attempt to raise money for its operating expenses.³⁹ Jack White, the Co-op's general manager, borrowed approximately four million dollars from the Co-op to construct and operate the gasohol plant of his company, White Flame Fuels, Inc. ("White Flame").⁴⁰ White and his accountant were later indicted on charges of tax fraud, and the Co-op ultimately decided to purchase White Flame and release White's debts.⁴¹

37. See Ingber, Note, *supra* note 12, at 378 n.184 (stating that *Reves* is a landmark decision because it represents "one of the first times the Supreme Court has limited RICO's application by side-stepping RICO's 'liberal construction clause' which directs the Court to interpret RICO's provisions liberally"). In several prior Supreme Court decisions, the Court had determined that it would not restrict civil RICO. See, e.g., *H.J., Inc. v. Northwestern Bell Tel. Co.*, 492 U.S. 229 (1989) (following traditional RICO jurisprudence by rejecting a suggested limitation to the pattern requirement); *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 497 (1985) (suggesting that a restrictive interpretation of the RICO provision at issue would contradict prior case law and general principles which construe RICO broadly). The departure from traditional RICO jurisprudence, however, appears to be limited to this specific context. In a recent decision, the Supreme Court once again rejected a limitation to a RICO substantive provision. See *National Org. For Women, Inc. v. Scheidler*, 114 S. Ct. 798 (1994) (stating that § 1962(c) does not require that the racketeering acts be economically motivated). The Court reiterated its prior support for broad interpretations of RICO, and indicated that Congress enacted RICO based on the "perceived need to combat organized crime. But Congress for cogent reasons chose to enact a more general statute, one which, although it had organized crime as its focus, was not limited in application to organized crime." *Id.* at 805 (citing *H.J. Inc., v. Northwestern Bell Tel. Co.*, 492 U.S. 229, 248 (1989)).

38. McDonough, Note, *supra* note 20, at 1125 (indicating that *Reves* will potentially limit an accountant's exposure to RICO liability, but recognizing that the precise parameters of this liability can only be ascertained by further litigation). See *infra* notes 293-302 and accompanying text (discussing future implications of the *Reves* decision); see also Harvey L. Pitt & Dixie L. Johnson, *Freeing Corporate Professional Advisers From the Threat of RICO Liability*, N.Y. L.J., Mar. 15, 1993, at 1, 4 (stating that, after the Supreme Court decided *Reves*, "relief surely could be heard emanating from accountants and attorneys" because the decision "narrows and curtails their possible exposure to RICO liability"). It is important to note that although *Reves* potentially limits professional liability under § 1962(c), other weapons may be available to attack professionals under RICO. See *infra* notes 73-76 (discussing other activities prohibited by RICO).

39. *Arthur Young v. Reves*, 937 F.2d 1310, 1315 (8th Cir. 1991), *cert. denied*, *Ernst & Young v. Reves*, 112 S.Ct. 1165 (1992), *aff'd* 113 S.Ct. 1163 (1993).

40. *Id.* Although White Flame began producing gasohol in 1980, White continued to borrow funds from the Co-op because the company experienced financial problems as a result of the "plant's poor design and outside economic factors." *Id.*

41. *Id.* at 1315-16. The indictment against White alleged that he engaged in a course of self dealing with the Co-op and that he filed fraudulent tax returns. *Id.* at 1315. Shortly

The Co-op retained the accounting firm of Arthur Young⁴² to perform its 1981 and 1982 audits.⁴³ Arthur Young calculated the fixed-asset value of White Flame and provided guidance on the treatment of that value for accounting purposes.⁴⁴ The date on which the Co-op acquired White Flame was essential to the valuation assessment.⁴⁵ Despite uncertainty about the acquisition date, Arthur Young valued White Flame at \$4.5 million.⁴⁶ However, Arthur Young failed to reveal to the Co-op's board of directors that without this higher valuation, the Co-op would be insolvent.⁴⁷

In 1984, the Co-op experienced a run on its demand notes and was unable to secure further financing.⁴⁸ As a result, the Co-op filed for bankruptcy, thereby preventing investors from redeeming their notes.⁴⁹

after he was indicted, White proposed that the Co-op assume his debts in exchange for White Flame's stock. *Id.* On November 12, 1980, the Board agreed to White's proposal and voted to acquire White Flame. *Id.* The Co-op filed a declaratory judgement against White and White Flame alleging that the stock had not been transferred, even though the Co-op had continued to invest in the plant, and had not executed a note assuming White's debts. *Id.* The parties filed a consent decree which provided that the Co-op owned White Flame as of February 15, 1980 and that White was relieved of his \$4 million debt. *Id.* at 1316. However, the minutes of the board meeting reveal that discussions to purchase White Flame did not take place until November 12, 1980. *Id.* at 1315.

42. *Id.* at 1315. Russell Brown & Co. merged with Arthur Young and Company in 1982, and later became respondent Ernst & Young. *Id.* In its opinion, the Supreme Court refers to the accounting firm as "Arthur Young" to remain consistent with previous judicial writings. *Reves*, 113 S. Ct. at 1167 n.2. Similarly, this Note refers to the firm as Arthur Young.

43. *Id.* at 1316-20.

44. *Id.*

45. *Id.* at 1317. According to Generally Accepted Accounting Principles, if the Co-op acquired the gasohol plant at its inception in 1979, then it should be valued at approximately \$4.5 million. *Id.* However, if the Co-op acquired the plant at a later date, by acquisition or purchase, for instance, then it would be assigned the fair market value at the time of the audit. *Id.* Arthur Young's valuation of the plant was much lower, ranging from approximately \$450,000 to \$1.5 million. *Id.* at 1317 n.7.

46. *Id.* at 1317.

47. *Id.* at 1317-18. Arthur Young valued the gasohol plant at the same figure used by the Co-op's previous accountants who had been convicted of tax fraud and had testified they fabricated the figures at White's request. *Id.* at 1317 n.4. The accounting firm did qualify its financial statement by noting that it was concerned that the Co-op would be unable to recover the losses generated by the plant. *Id.* at 1317. Nonetheless, the firm did not reveal to the board that it also was concerned about the valuation of the plant. *Id.*

48. *Id.* at 1321. As a result of an increasing demand by investors to redeem their investments, the Co-op attempted to increase its line of credit from the Cooperative Finance Association ("CFA"). *Id.* CFA refused to advance the Co-op additional funds because the total demand note investment in the Co-op had dropped below \$9.5 million. *Id.*

49. *Id.* The notes were frozen in the bankruptcy estate. *Id.*

The trustee in bankruptcy filed a class action⁵⁰ in the United States District Court for the Western District of Arkansas on behalf of certain demand noteholders.⁵¹ The plaintiffs claimed that Arthur Young, a material participant in the operation and management of the Co-op, violated section 1962(c) of RICO by fraudulently preparing financial data and concealing that data from the Co-op.⁵² The district court granted the accounting firm's motion for summary judgment after finding that Arthur Young's involvement in the Co-op did not rise to a level of operation or management as required by section 1962(c).⁵³ The district court applied the Eighth Circuit's operation or management test, adopted in *Bennett v. Berg*,⁵⁴ to determine that Arthur Young's participation did not constitute a RICO violation.⁵⁵

The United States Court of Appeals for the Eighth Circuit affirmed the district court's grant of summary judgment.⁵⁶ The court of appeals also applied the *Bennett* formulation, which "require[s] some participation in the operation or management of the enterprise itself."⁵⁷ Based on Arthur Young's limited involvement, the appellate court determined that

50. *Id.* at 1322. The district court certified a class of noteholders, consisting of individuals who had purchased demand notes from the Co-op between February 15, 1980 and February 23, 1984. *Id.*

51. *Id.*

52. *Id.* The Co-op's bankruptcy gave rise to other litigation. See *Reves v. Ernst & Young*, 494 U.S. 56 (1990) (holding that the demand notes were securities under federal securities laws).

53. *Arthur Young*, 937 F.2d at 1321-24. After trial, the jury found that Arthur Young had committed both state and federal securities fraud and calculated the plaintiffs' damages at \$6,121,652.94 as a result of the fraud. *Id.*

54. 710 F.2d 1361, 1364 (8th Cir.) (en banc), *cert. denied*, *Prudential Ins. Co. of Am. v. Bennett*, 464 U.S. 1008 (1983). See *infra* notes 180-93 and accompanying text (discussing the Eighth Circuit's operation or management test).

55. *Arthur Young*, 937 F.2d at 1324. The court of appeals cited the district court opinion:

Plaintiffs have failed to show anything more than that the accountants reviewed a series of completed transactions, and certified the Co-op's records as fairly portraying its financial status as of a date three or four months preceding the meetings of the directors and the shareholders at which they presented their reports. We do not hesitate to declare that such activities fail to satisfy the degree of management required by *Bennett v. Berg*.

Reves v. Ernst & Young, 113 S. Ct. 1163, 1168 (1993).

56. *Arthur Young*, 937 F.2d at 1324.

57. *Id.* The court of appeals acknowledged the inconsistent interpretations among the federal circuits, but found that it was bound by precedent until the Supreme Court rejected the operation or management standard. *Id.* See *infra* notes 132-202 and accompanying text (discussing the conflict between the federal circuits over the level of participation required by § 1962(c)).

the plaintiffs failed to satisfy the test.⁵⁸ The appellate court concluded that despite the improprieties perpetuated by Arthur Young, the accounting firm's actions were insufficient to trigger RICO liability.⁵⁹

The United States Supreme Court affirmed the Eighth Circuit's decision⁶⁰ and adopted the Eighth Circuit's operation or management test as the proper legal standard in evaluating the level of participation required by section 1962(c).⁶¹ The Court determined that the term "conduct," as used in section 1962(c), imports some degree of direction.⁶² The Court found that this formulation is consistent with both the legislative history of RICO⁶³ and the congressional mandate to construe the Act liberally.⁶⁴ The Court concluded that Arthur Young's failure to inform the Co-op's board of directors of its potential insolvency did not constitute participation in the operation or management of the Co-op's affairs.⁶⁵

In a dissenting opinion, Justice Souter, joined by Justice White, rejected both the operation or management test and the majority's application of that test to Arthur Young's involvement with the Co-op.⁶⁶ The dissent found that the language of section 1962(c) was ambiguous, thereby mandating deferral to the statute's liberal construction clause, which was "not irrelevant, but dispositive."⁶⁷ Furthermore, the dissent argued that even if it did accept the majority's view of section 1962(c), it could not join in the judgment because, in its view, the majority misapplied its own test.⁶⁸ The dissent found that when Arthur Young created the financial reports that failed to disclose the Co-op's insolvency, it engaged in the execution

58. *Id.* (stating that Arthur Young's involvement "was limited to the audits, meetings with the Board of Directors to explain the audits, and presentations at the annual meetings").

59. *Id.* (stating that "it is clear that Arthur Young committed a number of reprehensible acts, but these acts in no way rise to the level of participation in the management or operation of the Co-op").

60. *Reves v. Ernst & Young*, 113 S. Ct. 1163 (1993). A majority of Justices affirmed the decision. Justices Scalia and Thomas joined the majority opinion, but did not join in Part IV-A. *Id.* at 1165 n.1. Justices Souter and White dissented. *Id.* at 1165.

61. *Id.* at 1173.

62. *Id.* at 1169.

63. *Id.* at 1170-72 (citing the numerous references to "management" and "operating" in the legislative history provisions discussing § 1962(c)).

64. *Id.* (arguing that the liberal construction clause does not apply because the statutory language and legislative intent are clear).

65. *Id.* at 1173-74.

66. *Id.* at 1175 (Souter, J. & White, J., dissenting).

67. *Id.*

68. *Id.* at 1178.

of a managerial function, rather than traditional auditing activity.⁶⁹ Thus, the dissent concluded that Arthur Young should incur RICO liability.⁷⁰

This Note examines whether professionals who perform fraudulent services and who are peripherally involved in an enterprise should be civilly liable under the conduct or participation requirement of section 1962(c). First, this Note presents an overview of traditional RICO jurisprudence, and the statute's history of liberal interpretation. Next, this Note compares and contrasts the circuit courts' restrictive and liberal interpretations of the participation requirement. This Note then analyzes the Supreme Court's opinion in *Reves v. Ernst & Young*, and argues that the adoption of an operation or management test is faithful to the statutory language and broad remedial purposes of RICO. Moreover, this test provides necessary parameters for interpreting the statutory guidelines in the specific context of independent professional service providers. This Note suggests that the majority's restrictive application of the operation or management test in *Reves* will perpetuate further confinement of RICO's participation requirement. This may effectively insulate professionals who perform peripheral services from future civil RICO liability and the severe threat of treble damages. This Note concludes that the majority in *Reves* has reached the appropriate result, because professionals who perform peripheral services, absent a higher level of culpability, are not the type of individuals civil RICO should target.

I. TRADITIONAL RICO JURISPRUDENCE

A. Overview of Criminal and Civil RICO

The RICO statute delineates standards of unlawful conduct enforceable through criminal and civil sanctions.⁷¹ In section 1962, the heart of RICO's substantive provisions, the Act proscribes four general types of

69. *Id.* at 1176 (asserting that Arthur Young had "step[ed] out of its auditing shoes and into those of management, in creating the financial record on which the Co-op's solvency was erroneously predicated").

70. *Id.*

71. 18 U.S.C. §§ 1961-68 (1988). RICO provides both a criminal and a private cause of action against any individual violating its substantive provisions. *Id.* §§ 1963-64. See *supra* note 6 (discussing generally criminal and civil penalties under RICO); *infra* note 82 (discussing RICO's criminal forfeiture provisions); *infra* notes 83-86 (discussing the treble damages awarded to private plaintiffs). The fundamental differences between a criminal and civil RICO action are the penalties imposed and the procedural mechanisms and safeguards inherent in the different causes of action. See, e.g., JED S. RAKOFF & HOWARD W. GOLDSTEIN, *RICO CIVIL AND CRIMINAL LAW AND STRATEGY* (1994) (providing a comprehensive evaluation of both criminal and civil RICO actions). A detailed comparison of the differences, however, is beyond the scope of this Note.

activities.⁷² First, RICO prohibits using income derived from a pattern of racketeering activity to acquire an interest in an enterprise.⁷³ Second, RICO prohibits acquiring or maintaining an interest in an enterprise through a pattern of racketeering activity.⁷⁴ Third, RICO prohibits conducting the affairs of an enterprise through a pattern of racketeering activity.⁷⁵ Finally, RICO makes it unlawful to conspire to commit any of these three activities.⁷⁶

These substantive provisions must be read in the context of the Act's statutory definitions. "[E]nterprise" is defined to "include[] any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity."⁷⁷ A "pattern of racketeering activity" requires at least two acts of

72. 18 U.S.C. § 1962(a)-(d) (1988). See *infra* notes 73-76 and accompanying text (providing the full text of the four activities RICO proscribes as unlawful conduct).

73. Section 1962(a) states in part:

It shall be unlawful for any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity or through collection of an unlawful debt in which such person has participated as a principal . . . to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in acquisition of any interest in, or the establishment or operation of, any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce.

18 U.S.C. § 1962(a) (1988). See *infra* notes 77-79 and accompanying text (defining enterprise, pattern of racketeering, and racketeering activity).

74. Section 1962(b) states: "It shall be unlawful for any person through a pattern of racketeering activity or through collection of an unlawful debt to acquire or maintain, directly or indirectly, any interest in or control of any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce." 18 U.S.C. § 1962(b) (1988).

75. Section 1962(c) states:

It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

Id. § 1962(c) (1988).

76. Section 1962(d) states: "It shall be unlawful for any person to conspire to violate any of the provisions of subsection (a), (b), or (c) of this section." *Id.* § 1962(d) (1988); see also Donald W. Cassidy, Comment, *Turning RICO on its Head: Schiffels v. Kemper Fin. Serv., Inc. and the Need to Limit Standing Under § 1962(d) to Plaintiffs Who Allege Injuries From Racketeering Acts*, 78 MINN. L. REV. 467, 485-89 (1993) (discussing the conflict among the federal circuits concerning the appropriate standing requirement to allege a private cause of action based on a RICO conspiracy violation).

77. 18 U.S.C. § 1961(4) (1988). An enterprise may be a legitimate or an illegitimate business entity. *United States v. Turkette*, 452 U.S. 576, 583 (1981) (stating that an enterprise "is proved by evidence of an ongoing organization, formal or informal, and by evidence that the various associates function as a continuing unit"); see also *United States v. Elliott*, 571 F.2d 880 (5th Cir.) (endorsing the government's contention that loosely knit associations constitute RICO enterprises), *cert. denied*, 439 U.S. 953 (1978). Courts have held that labor unions and law firms may be RICO enterprises. See *United States v. Provenzano*, 688 F.2d 194 (3d Cir.) (finding a labor union to be a RICO enterprise), *cert.*

"racketeering activity" committed within a ten year period.⁷⁸ The statute classifies three broad categories of crimes as racketeering activity.⁷⁹

RICO operates in both the criminal and civil context.⁸⁰ Section 1963 sets forth the criminal sanctions for violations of section 1962.⁸¹ RICO's most significant criminal enforcement mechanism is its forfeiture provision. Under this provision, convicted defendants may be required to forfeit both the ill-gotten gains they have acquired, and the economic base they command, because the financial or property interest controlled by the defendants enable them to exert power over the enterprise involved.⁸² The private civil enforcement mechanism appears in section

denied, 459 U.S. 1071 (1982); *United States v. Scotto*, 641 F.2d 47 (2d Cir. 1980) (holding that a labor union constituted a RICO enterprise), *cert. denied*, 452 U.S. 961 (1981); *United States v. Jannotti*, 729 F.2d 213 (3d Cir.) (holding that a law firm constituted a RICO enterprise), *cert. denied*, 469 U.S. 880 (1984).

78. 18 U.S.C. § 1961(5) (1988). See *H.J., Inc. v. Northwestern Bell Tel. Co.*, 492 U.S. 229, 239 (1989) (stating a "pattern of racketeering" requires a showing that the predicate acts "are related, and that they amount to or pose a threat of continued criminal activity") (emphasis in original); *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 496 n.14 (1985) (stating that it is the "factor of continuity plus relationship which combines to produce a pattern" that must include at least two isolated acts of racketeering) (emphasis in original). But see Posner, Note, *supra* note 13, at 1747 (arguing that despite *Sedima's* interpretation of the pattern element, courts do not have a consistent approach to the requirement).

79. The three categories of crimes are: any of several specified acts, including murder and arson, chargeable under State law and punishable by imprisonment for more than one year; any act which is indictable under any of the several specified sections of Title 18, U.S.C., or federal offenses involving narcotics or other dangerous drugs. 18 U.S.C. § 1961(1) (1988); see also *United States v. Elliott*, 571 F.2d 880, 897 (5th Cir.) (outlining the three categories of crimes), *cert. denied*, 439 U.S. 953 (1978). Most civil RICO claims allege mail, wire, or securities fraud as the predicate offense. See Getzendanner, *supra* note 8, at 678; Posner, Note, *supra* note 13, at 1747 n.14 (stating that "[i]t is the inclusion of these predicate acts [of mail, wire, and securities fraud] which has led to the unexpectedly broad application of civil RICO"); TASK FORCE REPORT, *supra* note 9, (providing statistics on the frequency in which mail, wire and securities fraud are used as predicate acts in civil RICO actions).

80. See *supra* note 71 (discussing the distinction between civil and criminal RICO actions).

81. Section 1963(a) provides:

Whoever violates any provision of section 1962 of this chapter shall be fined under this title or imprisoned not more than 20 years (or for life if the violation is based on a racketeering activity for which the maximum penalty includes life imprisonment), or both, and shall forfeit to the United States, irrespective of any provision of state law (1) any interest the person has acquired or maintained in violation of section 1962; (2) any (A) interest in; (B) security of; (C) claim against; or (D) property or contractual right of any kind affording a source of influence over; any enterprise which the person has established, operated, controlled, conducted, or participated in the conduct of, in violation of section 1962.

18 U.S.C. § 1963(a) (1988 & Supp. II 1990).

82. *Id.* § 1963(a). The Supreme Court addressed RICO's criminal forfeiture provision in *Alexander v. United States*, 113 S. Ct. 2766 (1993). In *Alexander*, the owner of an adult entertainment business was required to forfeit his business and the assets derived from his

1964(c).⁸³ It is designed to provide a civil RICO victim with adequate compensation and to discourage individuals from engaging in activity that would violate RICO.⁸⁴ Similar to antitrust law, RICO's private enforcement mechanism permits recovery for treble damages,⁸⁵ which creates an economic incentive for private plaintiffs to attack organized crime.⁸⁶ Finally, Congress has directed that courts construe RICO's provisions liberally to effectuate the statute's remedial purposes.⁸⁷

activities after he was convicted of three RICO counts predicated on 17 obscenity convictions. *Id.* at 2769-70. Alexander contested the forfeiture order on the grounds that it violated his First Amendment right to free speech and was disproportionate to the gravity of the crime. *Id.* at 2770. The Supreme Court rejected the First Amendment challenge and stated that RICO requires forfeiture of assets "because of the financial role they play in the operation of the racketeering enterprise." *Id.* at 2772. RICO is "not a prior restraint on speech, but a punishment for past criminal conduct." *Id.* The Court remanded the case to the Eighth Circuit to determine the proportionality of the forfeiture to the crime. *Id.* at 2776; *see also* *Russello v. United States*, 464 U.S. 16 (1983) (ordering the forfeiture of insurance proceeds from criminal arson activities after finding that a defendant's "ill-gotten gains" include both profits and proceeds derived from racketeering); *United States v. Cauble*, 706 F.2d 1322 (5th Cir. 1983) (requiring that an entire partnership interest, an economic base, be forfeited), *cert. denied*, 465 U.S. 1005 (1984); *Blakey & Gettings*, *supra* note 2, at 1033-35 (providing a detailed description of criminal RICO).

83. 18 U.S.C. § 1964(c) (1988). Section 1964(c) provides: "Any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee." *Id.*

84. *Blakey*, *supra* note 8, at 878 (stating that a private RICO cause of action "'deter[s] violators and provide[s] ample compensation to . . . victims'" (alteration in original) (quoting *Blue Shield of Va. v. McCready*, 457 U.S. 465, 472 (1982)); *Goldsmith & Linderman*, *supra* note 13, at 834-35 (arguing that treble damages are appropriate because they serve a deterrent and compensatory function). Many commentators note that RICO's civil enforcement mechanism was an extremely late addition to the Act and was not extensively discussed in the legislative history. *See, e.g.*, *Getzendanner*, *supra* note 8, at 677-78 (stating that "[e]veryone who has examined the legislative history of RICO, [with one exception], has pointed out that Congress added the private civil treble damages remedy to RICO with virtually no consideration of its purpose or consequences") (footnote omitted). *Id.*

85. 18 U.S.C. § 1964(c) (1988). RICO's treble damages provision is only available to a private plaintiff and is modeled after antitrust law. *Blakey*, *supra* note 8, at 878; *see also* 15 U.S.C. § 15 (1988) (stating that "any person who shall be injured in his business or property . . . may sue therefor in any district court . . . and shall recover threefold the damages").

86. *See* Judith A. Morse, Note, *Treble Damages Under RICO: Characterization and Computation*, 61 NOTRE DAME L. REV. 526, 533-34 (1986). The author describes RICO's purpose as "(1) encourag[ing] private citizens to bring RICO actions, (2) deter[ring] future violators, and (3) compensat[ing] victims for all accumulative harm. These multiple and convergent purposes make the treble damage provision a powerful mechanism in the effort to vindicate the interests of those victimized by crime." *Id.* (footnote omitted).

87. Organized Crime Control Act of 1970, Pub. L. No. 91-452, § 904 (a), 84 Stat. 947 (codified at 18 U.S.C. § 1961 (1988)). *See supra* note 17 (providing text of the legislative statement).

*B. The Supreme Court's Liberal Interpretation and
Expansion of RICO*

RICO is one of the most sophisticated and complicated federal statutes.⁸⁸ Scholars who have studied the Act disagree as to RICO's proper use in the civil and criminal contexts.⁸⁹ While some praise RICO's success as an innovative and flexible weapon to attack organized criminal behavior,⁹⁰ others criticize RICO's frequent use in the civil context and assert that many private actions are abusive.⁹¹ Traditionally, because of its broad statutory language and its liberal construction clause,⁹² the Supreme Court has been reluctant to place limits on RICO's statutory scope.⁹³ Arguably, the Court's liberal interpretation of RICO has resulted in the statute's application to situations unintended by its drafters.⁹⁴

88. See, e.g., *Sun Sav. & Loan Ass'n v. Dierdorff*, 825 F.2d 187, 196-97 (9th Cir. 1987) (Burns, J., concurring) (describing RICO as an "agonizingly difficult and confusing area of the law," and calling for congressional reform to curb further RICO expansion); Blakey & Gettings, *supra* note 2, at 1014 (stating that RICO is "one of the most sophisticated statutes ever enacted by Congress"); see Lynch, *supra* note 4, at 661 (indicating that RICO's broad draftsmanship has generated many attempts to resolve the numerous issues of interpretation presented by the Act).

89. See *supra* notes 11-16 (surveying the criticisms of RICO); *infra* notes 90-99 (comparing the views of the proponents and critics of RICO).

90. Blakey, *supra* note 8, at 875, 881 (stating that RICO embodies an "innovative approach to crime control"). Its effective use against sophisticated forms of criminality has prompted many states to adopt similar legislation. *Id.*

91. See *supra* notes 11-16 and accompanying text (discussing the criticisms of RICO in the civil context).

92. See *supra* notes 17, 87 (discussing RICO's liberal construction clause).

93. See *Tafflin v. Levitt*, 493 U.S. 455, 459 (1990) (rejecting a contention that federal courts have exclusive jurisdiction over RICO claims); *H.J., Inc. v. Northwestern Bell Tel. Co.*, 492 U.S. 229 (1989) (cautioning that restrictive interpretations of the statute are impermissible because they might frustrate Congress' remedial purposes); *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 497-98 (1985) (rejecting an attempt to augment RICO's standing requirement to include an allegation of a separate racketeering injury); *Russello v. United States*, 464 U.S. 16 (1983) (stating that, based on the statute's breadth and the congressional directive to interpret RICO liberally, the profits and proceeds derived from racketeering are subject to RICO's forfeiture provision); *United States v. Turkette*, 452 U.S. 576, 583 (1981) (rejecting the argument that a RICO enterprise can only be a legitimate business entity). In addition, some commentators argue that it is inappropriate for the judiciary to attempt to restrict the statute. See, e.g., Note, *Civil RICO: The Temptation and Impropriety of Judicial Restrictions*, 95 HARV. L. REV. 1101, 1118-20 (1982) (arguing that the broad statutory language and congressional intent underlying RICO prohibits judicial restriction).

94. See SMITH & REED, *supra* note 11, § 1.01, at 1-5 (stating that courts, rather than confining the application of RICO to "known mobsters," have permitted the Act to target "a wide variety of persons and situations not envisioned by the enacting Congress") (footnotes omitted); Reed, *supra* note 13, at 692-96 (arguing that the expansive reach and unintended consequences of RICO are attributable to the failure of federal courts to restrict the three core elements of the statute: predicate acts, a pattern of racketeering conduct,

1. Criminal Interpretation and Expansion

Since RICO's enactment, the Supreme Court has enunciated guidelines to interpret RICO's statutory provisions.⁹⁵ The Court demonstrated the Act's breadth in the context of a criminal RICO prosecution in *United States v. Turkette*.⁹⁶ In *Turkette*, the Court indicated that it will reject interpretations that clearly depart from RICO's statutory language⁹⁷ because rules of statutory construction are designed to resolve and not create ambiguity.⁹⁸ In construing the scope of a statute where the language

and an involved enterprise); see also Getzendanner, *supra* note 8, at 675, 679-81 (proposing to eliminate mail, wire, and securities fraud as RICO predicate offenses so civil recovery would be available to the appropriate victims—victims of classic mobster behavior).

95. Prior to *Reves v. Ernst & Young*, 113 S. Ct. 1163 (1993), and *Alexander v. United States*, 113 S. Ct. 2766 (1993) (addressing RICO's criminal forfeiture provision), the Supreme Court had interpreted RICO's provisions on nine occasions. See *Holmes v. Securities Investor Protection Corp.*, 112 S. Ct. 1311, 1317 (1992) (holding that a private plaintiff must establish that the defendant's RICO violation proximately caused the plaintiff's injury in order to recover under § 1964(c)); *Tafflin v. Levitt*, 493 U.S. 455 (1990) (holding that states have concurrent subject matter jurisdiction over civil RICO claims); *H.J., Inc. v. Northwestern Bell Tel. Co.*, 492 U.S. 229, 239 (1989) (interpreting the definition of "pattern of racketeering activity" to require a showing that "the racketeering predicates are related, and that they amount to or pose a threat of continued criminal activity." (emphasis in original)); *Fort Wayne Books, Inc. v. Indiana*, 489 U.S. 46 (1989) (addressing RICO's criminal forfeiture provision); *Agency Holding Corp. v. Malley-Duff & Assocs.*, 483 U.S. 143 (1987) (holding that a four year statute of limitations applies to civil RICO claims); *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987) (determining that civil RICO claims are amenable to arbitration); *Sedima, S.P.R.L.*, 473 U.S. at 479 (rejecting the imposition of a special racketeering injury requirement to prove a RICO violation); *American Nat'l Bank & Trust Co. v. Haroco, Inc.*, 473 U.S. 606 (1985); *Russello*, 464 U.S. at 16 (holding that criminal forfeiture may include the profits and proceeds the defendant has acquired through racketeering activity); *Turkette*, 452 U.S. at 583 (holding that both legitimate and criminal enterprises can satisfy RICO's enterprise element).

96. 452 U.S. 576 (1981).

97. *Id.* at 581 (the court noted that "[t]he Court of Appeals . . . clearly departed from and limited the statutory language. It gave several reasons for doing so, none of which is adequate.").

98. *Id.* at 587 n.10. The Court noted that it was inappropriate to apply the rule of lenity, a maxim requiring strict construction of criminal statutes, because there was no ambiguity in the RICO provisions at issue. *Id.* The Court proposed that:

[t]he canon in favor of strict construction [of criminal statutes] is not an inexorable command to override common sense and evident statutory purpose Nor does it demand that a statute be given the 'narrowest meaning'; it is satisfied if the words are given their fair meaning in accord with the manifest intent of the lawmakers.

Id. at 587-88 n.10 (quoting *United States v. Brown*, 333 U.S. 18, 25 (1948)). Additionally, the Court rejected the appellate court's reliance on the rule of *ejusdem generis*, which is a tool of statutory interpretation, by "suggesting that where general words follow a specific enumeration of persons or things, the general words should be limited to persons or things similar to those specifically enumerated." *Id.* at 581. Again, the Court instructed that rules of statutory construction "come[] into play only when there is some uncertainty as to the meaning of a particular clause in a statute." *Id.*

is unambiguous, the Court noted that the statute's language is dispositive unless Congress has indicated a contrary interpretation.⁹⁹

The *Turkette* Court interpreted the parameters of the term "enterprise" in section 1962(c) to include illegitimate as well as legitimate entities.¹⁰⁰ The Court reversed the First Circuit, which supported the defendant's contention that section 1962(c) does not apply to illegal enterprises, but only to the infiltration of legitimate businesses.¹⁰¹ Such an interpretation, the Court found, contradicted the plain language of the statute.¹⁰² The Court reasoned that if Congress had intended to exclude individuals whose purpose was exclusively criminal, then it would have included the word "legitimate" in the definition of enterprise.¹⁰³ Moreover, the Court found that the congressional declaration "to seek the eradication of organized crime"¹⁰⁴ supported its determination.¹⁰⁵ The Court concluded that the incorporation of illegitimate entities into the definition of an enterprise was clearly within this broad purpose.¹⁰⁶ Thus, the Court broadly interpreted the term "enterprise" in section 1962(c) in accordance with

99. *Id.* at 580 (noting that, after initial examination, "[i]f the statutory language is unambiguous, in the absence of 'a clearly expressed legislative intent to the contrary, that language must ordinarily be regarded as conclusive'" (quoting *Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980))). The Court indicated, however, that a conclusive method of determining "unambiguous" language does not exist. *Id.*

100. *Id.* at 593. In *Turkette*, a group of individuals associated for the purposes of engaging in narcotics trafficking, arson, bribery, and fraud. *Id.* at 579; *see also*, Lynch, *supra* note 4, at 700-06 (discussing the facts and significance of *Turkette*). The author asserts that "the use of RICO against illicit enterprises would become the most important, and the most radical, application of the criminal provisions of RICO." *Id.* at 699-700. This is significant because "[a]fter *Turkette*, RICO makes it a crime not only to infiltrate or corrupt legitimate enterprises, but also to be a gangster, whether in the Mafia or in a much more loosely affiliated criminal combine." *Id.* at 706.

101. *United States v. Turkette*, 632 F.2d 896 (1st Cir. 1980) (arguing that the extension of RICO would collapse the enterprise requirement into the pattern of racketeering requirement), *rev'd*, 452 U.S. 576 (1981). The Supreme Court recognized that "proof used to establish these separate elements may in particular cases coalesce, [but] proof of one does not necessarily establish the other." *Turkette*, 452 U.S. at 583. The Court concluded that "the Government must prove both the existence of an 'enterprise' and the connected 'pattern of racketeering activity.'" *Id.*

102. *Turkette*, 452 U.S. at 580 (stating that the definition of "enterprise" in § 1961(4) requires an association of individuals in fact, but does not place any limitations upon the association).

103. *Id.* at 580-81.

104. Organized Crime Control Act of 1970, Pub. L. No. 91-452, 84 Stat. 922, 941-48 (1970) (codified at 18 U.S.C. § 18 (1988)). *See supra* note 3 (providing a detailed statement of these findings).

105. *Turkette*, 452 U.S. at 589.

106. *Id.*

the legislative intent to promote legitimate law enforcement measures against the evils of organized crime.¹⁰⁷

2. Civil RICO Jurisprudence

In contrast to the broad application of criminal RICO, federal courts attempted to place limits on the statute's use in the civil context.¹⁰⁸ The Supreme Court, however, continued to use a liberal approach by broadly applying RICO in civil cases.¹⁰⁹ In *Sedima, S.P.R.L. v. Imrex Co.*,¹¹⁰ the Court approved the use of RICO in the civil context, but refrained from giving such application complete legitimacy.¹¹¹ In *Sedima*, the United States Court of Appeals for the Second Circuit strictly interpreted section 1964(c)¹¹² by imposing extrajudicial limitations on the language of the statute.¹¹³ Despite legitimate concerns regarding the overbreadth of civil

107. *Id.* (indicating that limiting an enterprise to include only legitimate business would place "[w]hole areas of organized criminal activity . . . beyond the substantive reach [of RICO]").

108. Federal courts attempted to restrict the reach of civil RICO by imposing four different limitations, reasoning that "Congress could not have intended to federalize all 'garden variety' fraud claims." Posner, Note, *supra* note 13, at 1749-53. A civil RICO plaintiff may be required to show: an "organized crime," a "competitive injury," a "racketeering injury," and a "prior conviction." *Id.* Similarly, some courts employed a "double standard" by only restricting the substantive requirements for a civil RICO action. See Reed, *supra* note 13, at 698 (discussing a federal court's endorsement of a broad pattern requirement in the criminal context, but not in the civil setting, demonstrating "a general judicial willingness to tolerate RICO's overbreadth in a criminal context, but not when applied in a civil prosecution"); see also GOLDSMITH & LINDERMAN, *supra* note 13, at 735 (discussing the absence of prosecutorial discretion when deciding to initiate a Civil RICO action).

109. One commentator noted that:

Private parties first began to use RICO's civil remedies after federal courts had upheld broad applications of RICO in criminal prosecutions. . . . Like federal prosecutors, civil RICO plaintiffs have relied on the broader RICO predicates such as the mail and wire fraud statutes to transform common-law contract and tort suits into RICO violations. While these civil claims fit squarely within RICO's accommodating language, federal courts and civil defense counsel initially recoiled at this use of RICO. The Supreme Court, however, already was committed to broad, literal interpretations of RICO when pressed by the government in criminal prosecutions and continued to interpret RICO's civil provisions broadly.

Reed, *supra* note 13, at 707 (footnotes omitted).

110. 473 U.S. 479 (1985).

111. *Id.* at 499-500. See *infra* notes 114-23 and accompanying text (discussing the Court's willingness to tolerate RICO's overbreadth in the civil context).

112. 18 U.S.C. § 1964(c) (1988). Section 1964(c) provides for a private civil action to recover treble damages for injury "by reason of a violation of" its substantive provisions. *Id.*

113. *Sedima, S.P.R.L. v. Imrex Co.*, 741 F.2d 482 (2nd Cir. 1984), *rev'd*, 473 U.S. 479 (1985). In *Sedima*, a Belgian corporation, after entering a joint venture with Imrex Co., instituted a civil RICO action against Imrex alleging overbilling. *Id.* at 484. The Second Circuit affirmed the dismissal of the RICO claim, and held that the prior conviction re-

RICO, the Supreme Court reversed the appellate court decision, and held that a civil action for treble damages under section 1964(c) can proceed even in the absence of a criminal conviction.¹¹⁴ The Court also rejected the notion that a plaintiff must have suffered a distinct "racketeering injury."¹¹⁵ Instead, the Court found that a plaintiff need only prove a violation of section 1962,¹¹⁶ and demonstrate that the defendant has caused injury by the commission of "predicate acts sufficiently related to constitute a pattern."¹¹⁷

The *Sedima* Court reasoned that the imposition of a racketeering injury requirement for recovery in a private civil RICO action was inappropriate in light of the principles surrounding RICO.¹¹⁸ These guiding principles include the congressional mandate to construe RICO liberally,¹¹⁹ recognition of the intentional breadth of the statutory language and overall approach,¹²⁰ and a commitment to support RICO's spirit in "develop[ing] new methods for fighting crime."¹²¹ In response to arguments that RICO is overbroad and over-used, the Court noted that Congress, not the judiciary, has the power to remedy such defects.¹²² Despite

quirement of § 1964(c) permitted private plaintiffs to use that section only against previously convicted criminal defendants. *Id.* Furthermore, the court determined that private plaintiffs could bring an action under § 1964(c) only when they had suffered an injury that RICO was designed to deter, such as a racketeering injury. *Id.*

114. *Id.* at 493. Specifically, the Court stated that *Sedima's* action was not barred by the fact that *Imrex* and the individual defendants had not been convicted of a criminal RICO violation or the predicate acts of mail and wire fraud. *Id.*

115. *Id.* at 495.

116. *Id.* at 496. The Court summarized § 1962's elements as follows: "(1) conduct (2) of an enterprise (3) through a pattern (4) of racketeering activity." *Id.* (footnote omitted). See *supra* notes 77-79 (discussing the elements in greater detail); *infra* notes 132-202 (discussing the various federal circuits approaches to the conduct requirement).

117. *Sedima*, 473 U.S. at 497. The Court elaborated on the pattern requirement by indicating that the pattern is equivalent to a threat of continuity of activity plus a "'relationship which combines to produce a pattern.'" *Id.* at 496 n.14 (quoting S. Rep. No. 91-617, p. 158 (1969)) (emphasis in original). The Court cited the legislative history to demonstrate that Congress did not intend RICO to target sporadic activity. *Id.*

118. *Id.* at 497 (stating that "[t]his less restrictive reading is amply supported by our prior cases and the general principles surrounding this statute").

119. *Id.*; see also *supra* notes 17, 87 (discussing the liberal construction clause).

120. *Sedima*, 473 U.S. at 498 (citing *United States v. Turkette*, 452 U.S. 576, 586-87 (1981)).

121. *Id.* at 498 (citing *Russello v. United States*, 464 U.S. 16, 26-29 (1983)).

122. *Id.* at 499-500. Justice White reasoned that RICO's ambiguity is attributable to the breadth of the statutory language, rather than its application in contexts not expressly intended by Congress. *Id.* at 499 (citing *Haroco, Inc. v. American Nat'l Bank & Trust Co.*, 747 F.2d 384, 398 (7th Cir. 1984)).

Justice White recognized that if the use of RICO to target legitimate businessmen rather than "the archetypal, intimidating mobster" is improper, it is a defect inherent in the statute and its remedy lies with Congress. *Id.* at 499 (footnote omitted). Justice White stated, "[i]t is not for the judiciary to eliminate the private action in situations where Congress has

its reluctance to constrict civil RICO, the Court acknowledged that "RICO is evolving into something quite different from the original conception of its enactors."¹²³

In dissent,¹²⁴ Justice Marshall and Justice Powell argued that the majority opinion incorrectly construed a RICO civil action to reach "garden-variety fraud and breach of contract cases,"¹²⁵ thereby radically altering federal civil litigation.¹²⁶ The dissent criticized the majority's interpretation of the Act's legislative history, arguing that Congress intended prosecutors to use RICO as a tool to combat organized crime, with only incidental effects in the civil context.¹²⁷ The dissent contended that the Court has a duty to interpret the statute narrowly and confine RICO's scope to those situations intended by Congress.¹²⁸ Moreover, the dissent found that the liberal interpretive principles enunciated in *Turkette*¹²⁹ were inapplicable in the civil context because the legislative statements

provided it simply because plaintiffs are not taking advantage of it in its more difficult applications." *Id.* at 499-500.

123. *Id.* at 500; see also *supra* notes 13-16 (discussing the notion that civil RICO has evolved beyond its intended statutory reach).

124. *Sedima*, 473 U.S. at 500 (Marshall, J., dissenting). Justice Marshall filed a dissenting opinion in which Justices Brennan, Blackmun, and Powell, joined. Justice Powell also filed a separate dissenting opinion. *Id.* at 503.

125. *Id.* at 525 (Powell, J., dissenting).

126. *Id.* at 500-03 (Marshall, J., dissenting). Justice Marshall argued that the majority's extension of § 1964(c) displaces existing federal laws and federal remedies. *Id.* at 502. For example, Justice Marshall discussed that a plaintiff can bring a civil RICO action by alleging two instances of "fraud in the sale of securities." *Id.* at 504 (quoting 18 U.S.C. § 1961(1) (1988)). RICO displaces federal securities laws because a plaintiff can avoid the standing requirements imposed by federal law by alleging other predicate acts under RICO, such as mail and wire fraud. *Id.* at 505. In addition, Justice Marshall recognized that "the federal securities laws contemplate only compensatory damages and ordinarily do not authorize recovery of attorney's fees. By invoking RICO, in contrast, a successful plaintiff will recover both treble damages and attorney's fees." *Id.* at 504-05. Justice Marshall noted that the lure of treble damages will lead to extortionate litigation. *Id.* at 504. The serious financial implications of litigation and the threat of being labeled a racketeer will compel civil RICO defendants to settle out of court. *Id.*; cf. *Holmes v. Securities Investor Protection Corp.*, 112 S. Ct. 1311, 1322 (1992) (O'Connor, J., concurring) (asserting that a RICO claim predicated on violations of fraud in the sale of securities does not require the purchaser/seller limitation applicable to a Rule 10b-5 private action).

127. *Sedima*, 473 U.S. at 506 (Marshall, J., dissenting) (stating that RICO's central purpose is to combat organized criminal behavior, which now constitutes only 9% of civil RICO cases) (citing TASK FORCE REPORT, *supra* note 9, at 69); see also *id.* at 526 (Powell, J., dissenting) (suggesting that "[t]he reach of the statute beyond traditional mobster and racketeer activity and comparable ongoing structured criminal enterprises, was intended to be incidental, and only to the extent necessary to maintain the constitutionality of a statute aimed primarily at organized crime") (citation omitted) (quoting TASK FORCE REPORT, *supra* note 9, at 71-72).

128. *Id.* at 527 (Powell, J., dissenting).

129. See *supra* notes 95-107 and accompanying text (discussing the Supreme Court's broad interpretation of RICO provisions in a criminal context).

supporting those principles were made in reference to a RICO criminal action.¹³⁰ Thus, the dissent concluded that the Court can and should curtail the unintended application of RICO in the civil context.¹³¹

II. SECTION 1962(c)—APPROACHES TO THE CONDUCT OR PARTICIPATION REQUIREMENT

Federal courts have continued to struggle in interpreting and applying the RICO provisions.¹³² Section 1962(c)'s phrase, "to conduct or participate, directly or indirectly, in the conduct of [the] enterprise"¹³³ was one of the few aspects of RICO that had not been previously litigated before the Supreme Court.¹³⁴ A complete understanding of the meaning of this phrase requires an examination of the relationship between the defendant and the enterprise, and specifically, the defendant's level of activity within that enterprise.¹³⁵ Federal courts refer to this substantive provision of section 1962(c) in a variety of ways, including the "nexus requirement," the "participation requirement," and the "conduct requirement."¹³⁶ As one federal appellate court judge observed, "the

130. *Sedima*, 473 U.S. at 528-29. Justice Marshall indicated that RICO's private civil provisions were added by the House of Representatives "almost as an afterthought" after the Senate had passed its version of the bill. *Id.* at 507. Upon Senate reconsideration, the bill passed without conference in an effort to enact RICO by the end of the term. *Id.* at 518-19. Justice Marshall speculated that, as a result, "the private remedy at issue here slipped quietly into the statute, and its entrance evinces absolutely no intent to revolutionize the enforcement scheme, or to give undue breadth to the broadly worded provision—provisions Congress fully expected Government enforcers to narrow." *Id.* at 519.

131. *Id.* at 523.

132. See, e.g., *Sun Sav. & Loan Ass'n v. Dierdorff*, 825 F.2d 187, 196-97 (9th Cir. 1987) ("RICO is for me (and many, if not most, of my district court colleagues) an agonizingly difficult and confusing area of the law."); *Goldman v. McMahan, Brafman, Morgan & Co.*, 706 F. Supp. 256, 261 (S.D.N.Y. 1989) (stating that "[t]he law surrounding the RICO statutory frame is a rapidly shifting, evolving corpus, whose practical interpretation presents a continual challenge to the courts"); see also Cassidy, Comment, *supra* note 76, at 469 (discussing differing approaches to RICO's conspiracy provision and noting the "continued efforts by federal courts to interpret the sweeping, innovative language of RICO while balancing the conflicting interpretive tensions between literalist and purposive constructions of the Act"); Posner, Note, *supra* note 13, at 1747 (stating that federal courts have been unable to define RICO's pattern element consistently).

133. See *supra* note 75 (providing the text of § 1962(c)).

134. See *supra* note 95 (discussing prior cases in which Supreme Court has interpreted RICO's provisions). In *Sedima*, the Supreme Court discussed the elements of § 1962(c), but did not provide further interpretive guidance. *Sedima*, 473 U.S. at 496.

135. See generally SMITH & REED, *supra* note 11, § 5.04, at 5-33 (discussing the requirements of § 1962(c)).

136. See, e.g., *Yellow Bus Lines, Inc. v. Drivers Local 639*, 913 F.2d 948 (D.C. Cir. 1990) (conduct or participation requirement), *cert. denied*, 111 S. Ct. 2839 (1991); *United States v. Yarbrough*, 852 F.2d 1522 (9th Cir.) (nexus requirement), *cert. denied*, 488 U.S. 866 (1988); *Bank of Am. Nat'l Trust & Sav. Ass'n v. Touche Ross & Co.*, 782 F.2d 966 (11th

Federal Circuits are all over the lot on this question.”¹³⁷ The United States Courts of Appeals have articulated five different approaches regarding the level of participation that RICO requires to hold a defendant liable under section 1962(c).¹³⁸ Using the same legislative history, statutory language, and case law, these courts have defined the legal standards to impose RICO liability for a broad spectrum of activity, ranging from mere participation to management and direction in the enterprise.¹³⁹

A. The Mere Relation Test

In *United States v. Scotto*,¹⁴⁰ the Second Circuit articulated the most expansive interpretation of section 1962(c)'s participation requirement. In this criminal case, the court evaluated the adequacy of a jury instruction, addressing the issue of whether the appellant conducted a union's affairs through a pattern of racketeering activity.¹⁴¹ The trial court formulated a “mere relation” approach, through which a prosecutor can satisfy RICO's nexus requirement in one of two ways:¹⁴² through proof of a relation between the defendant's predicate offenses and the enterprise's affairs, or through evidence that the defendant's position within the enterprise enabled him to commit the predicate offenses.¹⁴³

Cir. 1986) (conduct requirement); *Bennett v. Berg*, 710 F.2d 1361 (8th Cir.) (same), *cert. denied*, 464 U.S. 1008 (1983); *United States v. Cauble*, 706 F.2d 1322 (5th Cir. 1983) (nexus requirement), *cert. denied*, 465 U.S. 1005 (1984); *United States v. Scotto*, 641 F.2d 47 (2d Cir. 1980) (same), *cert. denied*, 452 U.S. 961 (1981). Although federal courts employ different language when discussing the substantive requirement of § 1962(c), essentially the statute requires the court to determine whether there is a substantial or meaningful connection between the defendant's pattern of racketeering and the affairs of the enterprise. See SMITH & REED, *supra* note 11, § 5.04, at 5-35 (discussing the nexus requirement and its application by various federal circuit courts).

137. *Yellow Bus Lines*, 913 F.2d at 957 (Mikva, J., concurring).

138. See *infra* notes 140-202 and accompanying text (discussing the five different legal standards used by the federal circuit courts).

139. See *infra* notes 140-57 (discussing the mere relation standard), 158-67 (discussing the facilitation standard), 168-79 (discussing the direct/indirect approach), 180-93 (discussing the operation or management test), 194-202 (discussing the significant control standard).

140. 641 F.2d 47 (2d Cir. 1980), *cert. denied*, 452 U.S. 961 (1981).

141. *Id.* at 54. In *Scotto*, the defendant, a union president, accepted several bribes from various union member employers in exchange for reducing the amount of worker compensation claims filed by the union. *Id.* at 51. The defendant requested a jury instruction that would require the jury to find that his activity “ ‘[a]ffected the [union's] affairs . . . in its essential functions.’ and was ‘concerned or related to the operation or management of the enterprise.’ ” *Id.* at 54 (quoting brief of appellant).

142. *Id.*

143. *Id.* The court stated:

[O]ne conducts the activities of an enterprise through a pattern of racketeering when (1) one is enabled to commit the predicate offenses solely by virtue of his position in the enterprise or involvement in or control over the affairs of the en-

Evaluating these criteria, the Second Circuit recognized that RICO does not qualitatively define the connection required between the defendant's activity and the defendant's involvement in the enterprise's affairs.¹⁴⁴ In the absence of a statutory definition of this nexus requirement, the court suggested that a broad range of relationships to the enterprise would trigger RICO liability.¹⁴⁵ Critics argue that the *Scotto* court did not give sufficient consideration to the conduct element of section 1962(c).¹⁴⁶ The Ninth and Third Circuits, however, subsequently adopted the *Scotto* standard.¹⁴⁷

terprise, or (2) the predicate offenses are related to the activities of that enterprise.

Id. There are several critics of the *Scotto* standard. See, e.g., SMITH & REED, *supra* note 11, § 504, at 5-41 to 5-42 (indicating that the precise meaning of the second element of *Scotto's* test, that predicate offenses be related to the activities of the enterprise, is not clear); Jed S. Rakoff, *Will the Supreme Court Come to Terms with RICO?*, N.Y. L.J., Sept. 10, 1992, at 3, 7 (arguing that *Scotto's* approach "sweeps far too broadly" and is inconsistent with both the structure of § 1962 and the language of subsection (c)).

144. *Scotto*, 641 F.2d at 54 (citing *United States v. Stofsky*, 409 F. Supp. 609, 613 (S.D.N.Y. 1973), *cert. denied*, 429 U.S. 819 (1976)). Using the *Stofsky* analysis, the *Scotto* court found that the nexus requirement does not require the predicate acts to further the enterprise or play a significant role in the usual operations of the enterprise. *Id.* Based on these conclusions, the *Scotto* court rejected the contention that a person must "solidify or otherwise enhance his position in the enterprise through [the] commission of the predicate violations." *Id.*; cf. *United States v. Rubin*, 559 F.2d 975, 990 (5th Cir. 1977) (noting that RICO requires some "relationship between the proscribed acts and the maintenance of union position"), *vacated on other grounds*, 439 U.S. 810 (1978).

145. *Scotto*, 641 F.2d at 54.

146. The conduct requirement of § 1962(c) requires "any person employed by or associated with any enterprise . . . to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs." 18 U.S.C. § 1962(c) (1988). Critics argue that the *Scotto* formulation of this substantive provision is too broad. See, e.g., *Yellow Bus Lines, Inc. v. Drivers Local 639*, 913 F.2d 948 (D.C. Cir. 1990), *cert. denied*, 111 S. Ct. 2839 (1991). The D.C. Circuit rejected *Scotto's* mere relation formulation as too lenient, because its application could potentially result in RICO liability for "[a]ny pattern of predicate acts remotely related to an 'enterprise,' whether committed by a mail clerk in the target enterprise or by the C.E.O. of the enterprise's business competitor." *Id.* at 952. The D.C. Circuit reasoned that "[i]f section 1962(c) can apply whenever predicate offenses are merely related to the activities of an enterprise, then the 'participation in the conduct' element of that section practically drops out." *Id.* (emphasis in original); see also *supra* note 143 (discussing other criticisms of the *Scotto* standard).

147. See *United States v. Yarbrough*, 852 F.2d 1522, 1544 (9th Cir.) (recognizing that the commission of predicate acts that "stem from" or are otherwise related to the enterprise satisfies the RICO "nexus" or "connection" requirement), *cert. denied*, 488 U.S. 866 (1988). The court imposed RICO liability where the defendant's commission of a theft related to a supremacist organization's attempt to raise money. *Id.*; *Sun Sav. & Loan Ass'n v. Dierdorff*, 825 F.2d 187, 195 (9th Cir. 1987) (stating that the "connection requirement is satisfied if [the defendant] was able to commit the fraud by virtue of his position with or work for [the enterprise] or if the fraud was related to [the enterprise's] business"). The court found that the complaint sufficiently alleged a RICO violation because the defendant committed several acts of mail fraud in his position as bank president and the mail fraud

Despite *Scotto's* broad formulation, courts applying the Second Circuit's mere relation approach have declined to impose RICO liability against independent accountants who perform peripheral financial services for the enterprise.¹⁴⁸ In *Plains/Anadarko-P Ltd. Partnership v. Coopers & Lybrand*,¹⁴⁹ the United States District Court for the Southern District of New York dismissed a RICO claim which was based on an accounting firm's certification of materially false financial statements.¹⁵⁰ The court indicated that the conduct or participation requirement is not satisfied "when a professional accountant enters an engagement of finite duration and scope, undertaken for a particular client."¹⁵¹ Using the *Scotto* test, the court concluded that the defendants did not conduct the challenged enterprise because ordinary auditing activity did not sufficiently establish one's relationship to, or position within, the enterprise.¹⁵² Similarly, in *Goldman v. McMahan, Brafman, Morgan & Co.*,¹⁵³ the same district court dismissed a RICO claim brought by investors in a limited partnership against the limited partnership and an accounting firm.¹⁵⁴ The court stated that the plaintiff must demonstrate a greater degree of correlation between the defendant and the enterprise than the relationship typically encountered between a client and an accountant.¹⁵⁵ The court reasoned that an accounting firm's performance of ordinary

related to the bank's activities. *Id.* United States v. Provenzano, 688 F.2d 194, 200 (3rd Cir.) (interpreting *Scotto* as standing for the proposition that "[i]t is only when the predicate acts are unrelated to the enterprise or the actor's association with it that the nexus element is missing, and consequently there is no RICO violation"), *cert. denied*, 459 U.S. 1071 (1982). The court found that the defendant violated RICO when he conducted his union office through racketeering activity by accepting bribes in exchange for overlooking violations of the collective bargaining agreement. *Id.*; *see also* Bank v. Wolk, 918 F.2d 418, 424 (3rd Cir. 1990) (affirming the dismissal of a RICO claim for the failure to satisfy the nexus requirement where the complaint did not allege a connection between the enterprise and the charge that the defendant "illegally financed a strawman").

148. Edward Brodsky, *RICO Liability of Accountants and Lawyers*, N.Y. L.J., Mar. 11, 1992, at 9 (stating that "despite the Second Circuit's expansive dicta in *Scotto*, an outside accounting firm will not be liable [under RICO] if all it does is perform typical accounting functions").

149. 658 F. Supp. 238 (S.D.N.Y. 1987).

150. *Id.* at 240 ("The claim attempts to squeeze an independent professional auditing engagement into the ferment of the RICO statutes, [which] . . . requires more than loose adjectives and characterizations to connect activities of an independent professional auditor with frauds committed by the enterprise being audited.").

151. *Id.* ("The auditing and reporting acts of the accountants, without more, would not establish a connection to the enterprise or the pattern requirements of the statutes.").

152. *Id.* (citing United States v. Scotto, 641 F.2d 47, 54 (2d Cir. 1980), *cert. denied*, 452 U.S. 961 (1981)).

153. 706 F. Supp. 256 (S.D.N.Y. 1989).

154. *Id.* at 256-57.

155. *Id.* at 262.

auditing activity was not a proper basis for a RICO claim.¹⁵⁶ Therefore, the court could not distinguish the case from *Plains/Andarko*.¹⁵⁷

B. The Facilitation Test

In *United States v. Cauble*,¹⁵⁸ the Fifth Circuit developed a "facilitation and effect" test, which closely parallels the Second Circuit's mere relation test, to assess whether the government established the nexus requirement of section 1962(c).¹⁵⁹ As a result of the perceived overbreadth of *Scotto's* language,¹⁶⁰ the *Cauble* court modified the *Scotto* test to incorporate a more restrictive standard.¹⁶¹ In doing so, the Fifth Circuit stated that the nexus element is satisfied when the commission of the predicate acts is facilitated by the defendant's position in the enterprise *and* when those acts affect the enterprise.¹⁶² The court explained that a defendant's predicate acts could affect the enterprise directly or indirectly,¹⁶³ and recognized that there was no requirement that the acts must benefit or advance the affairs of the enterprise.

The *Cauble* court concluded that the government satisfied the facilitation aspect of the nexus requirement by demonstrating that the defendant, a successful businessman, provided funds and other assets used in a smuggling operation by virtue of his position in the enterprise.¹⁶⁴ The court also concluded that, through the defendant's assistance, the smuggling operation provided substantial financial resources to the enterprise,

156. *Id.*

157. *Id.* at 261.

158. 706 F.2d 1322 (5th Cir. 1983), *cert. denied*, 465 U.S. 1005 (1984).

159. *Id.* at 1332-33. In *Cauble*, a wealthy Texas businessman was charged with commanding the "'Cowboy Mafia,' a loosely-knit group responsible for importing and distributing over 147,000 pounds of marijuana" during a two year period. *Id.* at 1329. The jury found the defendant guilty of the substantive RICO violations, including § 1962(c), and the trial judge ordered forfeiture of his interest in Cauble Enterprises. *Id.* at 1329-30.

160. See *supra* note 143 (stating the *Scotto* standard).

161. *Cauble*, 706 F.2d at 1332 (restricting the nexus requirement "because the enterprise-racketeering nexus should be distinct from the defendant-racketeering connection").

162. *Id.* at 1332-33. The *Cauble* court set out a three prong test, requiring that "(1) the defendant has in fact committed the racketeering acts as alleged; (2) the defendant's position in the enterprise facilitated his commission of the racketeering acts, and (3) the predicate acts had some effect on the lawful enterprise." *Id.* (footnote omitted).

163. *Id.* at 1333 n.24 ("The effect may be direct, such as the deposit of money in the enterprise's bank account, or indirect, such as the retention of the enterprise's existing clients.").

164. *Id.* at 1341. The court found that the evidence was sufficient for a reasonable jury to conclude that "none of the acts of travel [used for the smuggling operations] would have occurred but for [the defendant's] ability to dispatch the Cauble Enterprises [sic] airplane and to use Cauble Enterprises' assets to pay for commercial flights." *Id.*

thereby satisfying the affect aspect of the nexus requirement.¹⁶⁵ The Sixth and Seventh Circuits subsequently adopted the *Cauble* formulation.¹⁶⁶

C. Direct/Indirect Test

In *Bank of America Nat. Trust & Sav. Ass'n. v. Touche Ross*,¹⁶⁷ the Eleventh Circuit announced another liberal interpretation of section 1962(c)'s conduct requirement. The court examined the application of section 1962(c) to certified public accountants who prepared audited financial statements and unqualified reports.¹⁶⁸ Here, the court reversed the United States District Court for the Northern District of Georgia's dismissal of the RICO claim, finding that the independent auditors assistance in the preparation and dissemination of false financial statements satisfied the participation element of section 1962(c).¹⁶⁹ The court construed conduct to mean "the performance of those activities necessary or helpful to the operation of the enterprise."¹⁷⁰

The Eleventh Circuit based its statutory analysis on the "directly or indirectly" language of section 1962(c).¹⁷¹ The court reasoned that this language contradicted the defendant's assertion that Congress imposed a conduct requirement in an attempt to limit the application of civil

165. *Id.* (noting that a jury could conclude that the successful smuggling operation resulted in large cash deposits to the enterprise's bank account).

166. *Overnite Transp. Co. v. Truck Drivers Local 705*, 904 F.2d 391, 394 (7th Cir. 1990) (affirming the dismissal of a RICO claim where the union's activities did not facilitate the racketeering activities); *United States v. Pieper*, 854 F.2d 1020, 1026 (7th Cir. 1988) (finding evidence sufficient to support a RICO claim by virtue of the defendant's position within the union enterprise); *United States v. Horak*, 833 F.2d 1235, 1239 (7th Cir. 1987) (applying the *Cauble* standard to affirm a criminal conviction and indicating that the term "conduct" does not mean to control or manage); *United States v. Qaoud*, 777 F.2d 1105 (6th Cir. 1985), *cert. denied*, 475 U.S. 1098, 1115 (1986) (citing *Cauble* for the proposition that there must be a nexus between the pattern of racketeering activity and the RICO enterprise to satisfy § 1962(c)); *United States v. Blackwood*, 768 F.2d 131 (7th Cir. 1985) (adopting the *Cauble* formulation).

167. 782 F.2d 966 (11th Cir. 1986).

168. *Id.* at 968. The financial statements prepared by the accountants were a prerequisite to the execution of a credit agreement between their client and a bank. *Id.* The client filed for bankruptcy two years after signing the financing agreement, and then subsequently settled with the bank, resulting in a loss of approximately \$16.7 million to the bank. *Id.*

169. *Id.* at 970. The court did not address the merits of the defendant's argument that independent auditors do not participate in an enterprise's affairs, because questions of fact are not addressed in a motion to dismiss. *Id.*

170. *Id.* (noting that the preparation of false financial statements promoted the enterprise because it induced the bank to approve the credit agreement).

171. *Id.*; see also *supra* note 75 (providing the full text of § 1962(c)).

RICO.¹⁷² Therefore, the Eleventh Circuit rejected the accounting firm's argument that it could avoid RICO liability unless the court found that its participation was significant.¹⁷³ The court suggested that the language demonstrates that section 1962(c) was designed to apply to a broader class of defendants.¹⁷⁴ This broader class of RICO defendants includes individuals participating in the enterprise's affairs as "insiders," as well as those "outsiders" who are merely associated with the enterprise.¹⁷⁵

The primary criticism of the Eleventh Circuit's formulation is that it fails to account for the inclusion of the word "conduct" in section 1962(c)'s participation requirement.¹⁷⁶ The Eleventh Circuit supported its position by stating that it did not require a conduct element in criminal RICO cases,¹⁷⁷ and therefore would not require it in civil RICO cases

172. *Bank of Am.*, 782 F.2d at 970.

173. *Id.*

174. *Id.* ("It is not necessary that a RICO defendant participate in the management or operation of the enterprise.")

175. *Id.* The Court indicated that "the RICO net is woven tightly to trap even the smallest fish, those peripherally involved." *Id.* (quoting *United States v. Elliott*, 571 F.2d 880, 903 (5th Cir.), *cert. denied*, 439 U.S. 953 (1978)); *see also* *United States v. Watchmaker*, 761 F.2d 1459, 1476 (11th Cir. 1985) (using similar language to describe RICO's breadth), *cert. denied*, 474 U.S. 1100 (1986).

176. *See* *Yellow Bus Lines, Inc. v. Drivers Local 639*, 913 F.2d 948, 953-55 (D.C. Cir. 1990), *cert. denied*, 111 S. Ct. 2839 (1991). The District of Columbia Circuit found the decision problematic for several reasons. First, the court interpreted the Eleventh Circuit formulation as a "strict benefits" test, which had been rejected by other federal circuit courts. *Id.* at 953; *see also* *United States v. Kovic*, 684 F.2d 512 (7th Cir.) (rejecting a benefits analysis), *cert. denied*, 459 U.S. 972 (1982); *United States v. Webster*, 639 F.2d 174 (4th Cir. 1981), (finding that participation does not require the defendant's actions to benefit the enterprise), *cert. denied*, 111 S. Ct. 2257 (1991). Second, the District of Columbia Circuit disagreed that the "directly or indirectly" language of § 1962(c) was inconsistent with an operation or management approach. *Yellow Bus Lines*, 913 F.2d at 953. The District of Columbia Circuit stated that outsiders are not eliminated as potential RICO defendants under an operation or management standard when that standard "can as easily be applied to—for example—an organized crime boss who pulls the strings of a corporation through a puppet president as it can to the corporation president himself." *Id.* Finally, the District of Columbia Circuit argued that, by ignoring the "conduct" language of § 1962(c), the decision circumvented Congress' intent to proscribe a greater degree of participation through the substantive provision of the subsection. *Id.* at 953-54.

177. *Bank of Am.*, 782 F.2d at 970 (supporting a broad interpretation of § 1962(c) by referring to the Fifth Circuit's statement in *Elliott*, that RICO can catch "even the smallest fish"). *See* *Watchmaker*, 761 F.2d at 1476 (finding sufficient evidence to support the finding that two members of the "Outlaws" participated in the affairs of a motorcycle gang by engaging in acts of drug dealing and extortion); *Elliott*, 571 F.2d at 899-900. In *Elliott*, the court failed to mention conduct, but stated:

[b]y committing arson, actively assisting a car theft ring, fencing thousands of dollars worth of goods stolen from interstate commerce, murdering a key witness, and dealing in narcotics, [two members of a loosely connected criminal enterprises] directly and indirectly participated in the enterprise's affairs through a pattern . . . of racketeering activity.

because the substantive requirements of section 1962(c) are the same for both actions.¹⁷⁸

D. The Operation or Management Test

In *Bennett v. Berg*,¹⁷⁹ the Eighth Circuit articulated a restrictive interpretation of the participation requirement, commonly known as the operation or management test.¹⁸⁰ In *Bennett*, members of a retirement community claimed that certain accountants and attorneys, among others,¹⁸¹ violated RICO by fraudulently promoting a retirement community ("the Village").¹⁸² The plaintiffs alleged that the defendants made materially false statements concerning the financial health of the Village.¹⁸³ The district court dismissed the complaint on the ground that the plaintiffs failed to allege the existence of an enterprise.¹⁸⁴ The Eighth Circuit heard the case en banc,¹⁸⁵ and affirmed a panel opinion reversing the district court's dismissal of the RICO claim.¹⁸⁶

The Eighth Circuit articulated the operation or management test to guide the district court on remand.¹⁸⁷ The court questioned the plaintiff's factual claim that each defendant participated in the conduct of the affairs of the enterprise in violation of section 1962(c).¹⁸⁸ The court indicated that an individual's mere participation in committing fraud in connection with the enterprise is insufficient to satisfy the requisite degree of participation required by the Act.¹⁸⁹ The *Bennett* court concluded that a plaintiff must prove that the defendant engaged in "some participation in the

Id.

178. *Bank of Am.*, 782 F.2d at 970 n.2 ("Although our prior decisions refusing to impose a 'conduct' requirement occurred in criminal context, all of them were interpretations of § 1962(c), which [also] provides [a] cause of action for civil RICO suits.").

179. 710 F.2d 1361 (en banc) (8th Cir.), cert. denied, 464 U.S. 1008 (1983).

180. See, e.g., *Yellow Bus Lines*, 913 F.2d at 953 (crediting *Bennett* with the formulation of the operation or management test).

181. *Bennett*, 710 F.2d at 1363. This case raised the issue of professional liability in the context of RICO. The defendants included Kenneth Berg, who was the founder of the Village, the Village itself, the Village's former accountants, and two attorneys formerly employed by various defendants. *Id.*

182. The Village consisted of approximately 2,500 residents. *Bennett v. Berg*, 685 F.2d 1053, 1056 (8th Cir. 1982).

183. *Id.*

184. *Id.* at 1056. Count I of the complaint alleged that all defendants had participated and conspired to participate in a pattern of racketeering activity through mail fraud. *Id.* at 1057.

185. *Bennett*, 710 F.2d at 1361.

186. *Id.* at 1365.

187. *Id.* at 1364.

188. *Id.*

189. *Id.*

operation or management of the enterprise itself" to establish RICO liability.¹⁹⁰ The en banc court, however, did not provide any statutory or legislative support for this formulation.¹⁹¹ Furthermore, the court declined to reject the analysis of the earlier panel decision, which acknowledged the breadth of RICO and the court's lack of authority to limit the statute's reach.¹⁹²

E. *The Significant Control Test*

The District of Columbia Circuit adopted a more restrictive form of the operation or management test in *Yellow Bus Lines, Inc. v. Drivers Local Union 639*.¹⁹³ There, the court determined whether a labor union's organization of a strike against an employer rose to the degree of conduct or participation sufficient to impose RICO liability under section 1962(c).¹⁹⁴ After reviewing the various federal circuit interpretations of section 1962(c)'s participation element,¹⁹⁵ the court held that a striking union does not participate in the enterprise's affairs when it engages in a pattern of racketeering activity resulting from strike-related violence.¹⁹⁶

The *Yellow Bus Lines* court reasoned that the operation or management test came closest to the true meaning of the statutory language and intent of Congress.¹⁹⁷ The court noted that if Congress had intended to federalize labor and other areas of law under the RICO statute, it would have indicated that intent "clearly and unequivocally."¹⁹⁸ In an effort to

190. *Id.*; compare *id.* with *United States v. Mandel*, 591 F.2d 1347, 1375-76 (4th Cir.) (concluding that the district court correctly interpreted § 1962(c) to require some involvement in the operation or management of the business because the legislative history repeatedly cited the word "operation" to describe the purpose of the subsection), *aff'd on other grounds*, 602 F.2d 653 (4th Cir. 1979), *cert. denied*, 445 U.S. 961 (1980). The *Mandel* court held that the transfer of a legitimate business to the defendant as a payoff for fraudulent activity did not satisfy § 1962(c)'s requirement of conducting or participating in the conduct of the business through the predicate crimes. *Id.* at 1347.

191. *Bennett*, 710 F.2d at 1364.

192. *Bennett v. Berg*, 685 F.2d 1053, 1063-64 (8th Cir. 1982) (rejecting many of the arguments criticizing RICO, including the federalization of some state claims, because Congress anticipated RICO's broad scope).

193. 913 F.2d 948, 956 (D.C. Cir. 1990), *cert. denied*, 111 S. Ct. 2839 (1991).

194. *Id.* at 949. The union conducted a four day strike for recognition against *Yellow Bus Lines, Inc.*, which later asserted a RICO claim against the union and Woodward, the union's business agent and trustee. *Id.* at 950.

195. *Id.* at 952-53.

196. *Id.* at 956 (holding that the Union's activities associated with the strike "do not constitute the sort of hijacking of [the enterprise], in the form of acquiring and exercising control over [the enterprise's] affairs, that the RICO statute was designed to combat").

197. *Id.* at 954.

198. *Id.* at 954-55. First, the court concluded that the *Bennett* standard is the best approach "[b]ecause 'conducting' connotes more than merely 'participating' in [the enterprise's] affairs." *Id.* at 954. "Conduct" represents the idea of management, direction, or

constrict the scope of civil RICO liability, the court placed greater emphasis on the requirement that a defendant exercise "significant control" over or within an enterprise.¹⁹⁹ The court stated that a defendant must participate in the direction or the control of the business' agenda to satisfy the control element of 1962(c).²⁰⁰ The District of Columbia Circuit's formulation, therefore, restricts the *Bennett* operation or management test by requiring that the plaintiff show the defendant's ability to "run[] the show."²⁰¹

III. *REVES*: A MODERN APPROACH TO RICO JURISPRUDENCE

In *Reves v. Ernst & Young*,²⁰² the Court, for the first time, addressed the phrase "to conduct or participate, directly or indirectly, in the conduct of [an] enterprise's affairs" in Section 1962(c).²⁰³ The Court considered whether this language required courts to impose RICO liability only after finding that the defendant actively engaged in the affairs of the enterprise itself.²⁰⁴ In a 7-2 decision, the Court affirmed the decisions of both the United States District Court for the Western District of Arkansas²⁰⁵ and the United States Court of Appeals for the Eighth Circuit²⁰⁶ by holding that a court must find that the defendant participated in the operation or management of the enterprise itself to impose liability under section 1962(c).²⁰⁷ In doing so, the Supreme Court adopted the Eighth Circuit's

other exercise of control such that one must participate in the "running of the show." *Id.* Second, the court rejected a broader interpretation of the participation requirement because it would "federalize broad areas of state common law of contracts, and 'RICOize' broad areas of labor law and other federal laws governing relationships not readily identifiable as being within the enacting intent of Congress." *Id.* at 955.

199. *Id.* at 954 (rejecting the argument that outsiders are precluded from liability under this formulation because "[t]he crucial question is not whether a person is an insider or an outsider, but whether and to what extent that person controls the course of the enterprise's business").

200. *Id.* (stating that RICO liability may be imposed where a defendant either "participates in directing the enterprise toward its preexisting goals or participates in exercising control over an enterprise so as to reset its goals").

201. *Id.*; see also *supra* notes 180-93 and accompanying text (discussing *Bennett's* operation or management standard).

202. 113 S. Ct. 1163 (1993).

203. *Id.* at 1166 (quoting 18 U.S.C. § 1962(c) (1988)). See *supra* note 95 (discussing the Court's previous interpretations of various RICO provisions).

204. *Reves*, 113 S. Ct. at 1166 (stating that "[t]he question presented is whether one must participate in the operation or management of the enterprise itself to be subject to liability under this provision"). See *Bennett v. Berg*, 710 F.2d 1361, 1364 (answering this question affirmatively).

205. *Robertson v. White*, 113 F.R.D. 20 (W.D. Ark. 1986).

206. *Arthur Young & Co. v. Reves*, 937 F.2d 1310, 1339-40 (8th Cir. 1991), *aff'd*, 113 S. Ct. 1163 (1993).

207. *Reves*, 113 S. Ct. at 1172.

operation or management test as the proper legal standard in determining the point at which liability will attach under section 1962(c).²⁰⁸ By applying the operation or management test to Arthur Young's activities,²⁰⁹ the Court concluded that the accountant's actions did not rise to the requisite level of participation to incur RICO liability.²¹⁰ This restrictive application of the operation or management test may effectively eliminate the use of RICO as a weapon against independent professionals as a class of defendants.²¹¹

A. The Majority Opinion—Adopting the "Operation or Management" Test

The majority analyzed RICO's language to determine the scope of the statute and to ascertain the meaning of the provision, "to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs."²¹² First, the majority reasoned that it should interpret the meaning of the word "conduct," uniformly throughout section 1962(c).²¹³ Justice Blackmun, writing for the majority, rejected the petitioner's contention that "conduct" means "to carry on," since such a broad reading would encompass almost any involvement with the affairs of the enterprise.²¹⁴ Rather, the context of the phrase suggests that "conduct," when used as both a noun and a verb in section 1962(c), implies some degree of direction.²¹⁵ The majority reasoned that if no element of direction was imported into the phrase, section 1962(c) would read to "participate, directly or indirectly in [an] enterprise's affairs," and the use of "conduct" as a noun would be unnecessary.²¹⁶

208. *Id.* at 1170.

209. *See supra* notes 39-52 and accompanying text (discussing Arthur Young's activities).

210. *Reves*, 113 S. Ct. at 1173-74.

211. *See infra* notes 288-302 and accompanying text (discussing the implications of the *Reves* decision and the future application of § 1962(c) to professionals).

212. *Reves*, 113 S. Ct. at 1169 (citing *United States v. Turkette*, 452 U.S. 576, 580 (1981)). *Turkette* explained that the statutory language is conclusive if it is unambiguous and a legislative intent to the contrary has not been stated. *Turkette*, 452 U.S. at 580.

213. *Reves*, 113 S. Ct. at 1169 (stating that "it seems reasonable to give each use a similar construction") (citing *Sorenson v. Secretary of Treasury*, 475 U.S. 851, 860 (1986)).

214. *Id.*

215. *Id.* (recognizing that the dissent agrees "that, when 'conduct' is used as a verb, 'it is plausible to find in it a suggestion of control' "). *Id.* (quoting *Reves*, 113 S. Ct. at 1174 (Souter, J., dissenting)).

216. *Id.* at 1169. The majority stated that "Congress could easily have written 'participate, directly or indirectly, in [an] enterprise's affairs,' but it chose to repeat the word 'conduct.' " *Id.* (alteration in original).

The majority then analyzed the meaning of the word "participate" within the context of section 1962(c).²¹⁷ It determined that the word has a narrower meaning than to "aid and abet," as suggested by the petitioners.²¹⁸ The Court inferred the parameters of the term by examining what Congress did and did not explicitly include in the subsection.²¹⁹ The majority concluded that Congress intended the word "participate" to mean "take part in," an interpretation consistent with the common understanding of the term.²²⁰ By combining the definitions of "conduct" and "participate," the majority concluded that an individual must take part in directing the affairs of the enterprise to trigger civil RICO liability under section 1962(c).²²¹

Moreover, the majority indicated that the "directly or indirectly" language of section 1962(c) will not limit the application of the operation or management test to individuals in a formal position within the enterprise.²²² Nor will its application be limited to those who have significant control over its affairs.²²³ Courts can find outsiders liable under section 1962(c) if they participate in the operation or management of the enterprise itself.²²⁴ The majority contemplated that individuals outside the enterprise may be subject to RICO liability if they conduct the affairs of the

217. *Id.* at 1170.

218. *Id.* The majority recognized that "participate" has been characterized as a word of breadth. *Id.* (citing *Russello v. United States*, 464 U.S. 16, 21-22 (1983)). See *infra* note 268 (discussing the *Russello* decision's directive for interpreting RICO provisions). The majority, nonetheless, rejected "aid or abet" as an interpretation of "participate," because it is too broad and "'comprehends all assistance rendered by words, acts, encouragement, support, or presence.'" *Reves*, 113 S. Ct. at 1170 (quoting *BLACK'S LAW DICTIONARY* 68 (6th ed. 1990)).

219. *Id.* For example, the inclusion of the term "participate" indicates that the phrase has a broader meaning than the conduct of affairs. *Id.* at 1169. Similarly, the inclusion of the term "conduct" twice in the phrase "'to conduct or participate . . . in the conduct of [the enterprise's] affairs'" infers an interpretation that is narrower than participation. *Id.* (quoting 18 U.S.C. § 1962(c) (1988)).

220. *Id.* at 1170 (quoting *WEBSTER'S THIRD NEW INT'L DICTIONARY* 1646 (1976)).

221. *Id.*

222. *Id.* at 1173.

223. *Id.* at 1170. The majority rejected the District of Columbia Circuit's formulation that § 1962(c) requires an individual to have "'significant control over or within an enterprise.'" *Id.* at 1170 n.4 (quoting *Yellow Bus Lines, Inc. v. Drivers Local Union 639*, 913 F.2d 948, 954 (D.C. Cir. 1990), *cert. denied*, 111 S. Ct. 2839 (1991)) (emphasis omitted); see also *supra* notes 194-202 and accompanying text (discussing the District of Columbia Circuit's significant control formulation). The majority rejected the petitioner's contention that the operation or management test is limited to upper management, and stated that "[a]n enterprise is 'operated' not just by upper management but also by lower-rung participants in the enterprise who are under the direction of upper management . . . [which include those] who exert control over it as, for example, by bribery." *Id.* at 1173.

224. *Id.* at 1172-73.

enterprise, rather than their own affairs.²²⁵ Only those who operate completely outside the enterprise will avoid RICO liability under section 1962(c).²²⁶

The majority found support for the operation or management test in RICO's legislative history.²²⁷ The majority asserted that the numerous legislative history references to "operation" and "management" confirmed its statutory analysis of section 1962(c).²²⁸ For example, the majority cited the views of the Department of Justice on a revised "RICO" bill proposed by the Senate.²²⁹ The Department of Justice praised the revised legislation because the " 'criminal provisions of the bill contained in Section 1962 are broad enough to cover most of the methods by which ownership, control and operation of business concerns are acquired.' " ²³⁰ The majority concluded that the legislative history illuminates Congress'

225. *Id.* at 1173.

226. *Id.*

227. Part IV-A of the opinion is dedicated to the majority's analysis of the legislative history. *Id.* at 1170-72. Justice Scalia and Justice Thomas joined in the majority opinion, but they did not join in Part IV-A. *Id.* at 1166.

228. *Id.* at 1170-72.

229. *Id.* at 1170-71. Senators Hruska and McClellan introduced S-1861 as a revision of their original bill, S-1623, to reflect the statute's expanded purpose " 'to prohibit the infiltration or management of legitimate organizations by racketeering activity or the proceeds of racketeering activity.' " *Id.* at 1171 (quoting S. 1861, 91st Cong., 1st Sess. §§ 1962 (b)-(c) (1969)) (emphasis in original). S-1861 later became §§ 1962(b) and (c) of RICO. *Id.* (citing G. Robert Blakey, *The RICO Civil Fraud Action in Context: Reflections on Bennett v. Berg*, 58 NOTRE DAME L. REV. 237, 264 n.76 (1982)).

230. *Id.* at 1171 (quoting *Measures Related to Organized Crime: Hearings Before the Subcommittee on Criminals and Procedures of the Senate Committee on the Judiciary*, 91st Cong., 1st Sess., 387 (1969) (statement of Will Wilson, Assistant United States Attorney General) (emphasis omitted)). The majority made additional references to operation and management. *Id.* at 1171-72. S-1861 eventually became Title IX of the Organized Crime Control Act. *Id.* at 1171. House and Senate reports accompanying the bill describe this provision as "proscribing the operation of any enterprise engaged in interstate commerce through a 'pattern of racketeering activity.' " *Id.* at 1172. (citing H.R. REP. NO. 1549, 91st Cong., 2d Sess., at 35 (1970); S. REP. NO. 617, 91st Cong., 2d Sess., at 34 (1969)) (emphasis omitted). Moreover, on the floor of Congress, subsection (c) was consistently referred to as prohibiting the operation of an enterprise through a pattern of racketeering activity. *Id.* at 1171. The Court also cited the remarks of individual members of Congress to support this proposition. *Id.* at 1171 n.7 (indicating Senator Byrd understood subsection (c) to require an individual "to acquire or operate such businesses by racketeering methods") (quoting 116 CONG. REC. 607 (1970)); *Id.* (indicating Senator McClellan understood subsection (c) to require an individual "to operate such a business by racketeering methods") (quoting 116 CONG. REC. 607 (1970)); *Id.* (indicating Senator Dole understood subsection (c) to require an individual to "acquire or operate such businesses by racketeering methods") (quoting 116 CONG. REC. 607 (1970)); *Id.* (indicating Representative Steiger understood subsection (c) to require an individual to "use . . . specified racketeering methods to acquire or operate commercial organizations") (quoting 116 CONG. REC. 607 (1970)).

intent to limit RICO liability to individuals participating in "the acquisition or operation of an enterprise."²³¹

Furthermore, the majority firmly rejected the congressional mandate to construe RICO liberally where both the congressional intent and the statutory language are clear.²³² The liberal construction clause, the majority noted, facilitates RICO's broad remedial purposes by "ensur[ing] that Congress' intent is not frustrated by an overly narrow reading of the statute."²³³ In the absence of statutory ambiguity, however, courts should not use the liberal construction mandate to expand the scope of RICO's provisions beyond their intended parameters.²³⁴

The majority concluded that Arthur Young's failure to inform the Co-op's board of directors of its potential insolvency did not rise to the level of operation or management of the enterprise.²³⁵ Arthur Young prepared the Co-op's financial statements and assessed the value of the Co-op's investment in the gasohol plant.²³⁶ Furthermore, the majority rejected the dissent's argument, based on the professional standards adopted by the accounting profession, that the creation of financial statements is a managerial function.²³⁷ The majority found that such standards do not define "management" for purposes of section 1962(c).²³⁸ Finally, the majority noted that both the district and circuit courts applied the proper legal standard, the operation or management test, in granting summary judgment in favor of Arthur Young.²³⁹

231. *Id.* at 1171. The majority found further support for this limitation in Senator McClellan's reassurance to RICO critics that appropriate restrictions were included in the substantive provisions of § 1962. *Id.* at 1172. He stated: "Unless an individual not only commits such a crime [a predicate act] but engages in a pattern of such violations, and uses that pattern to obtain or operate an interest in an interstate business, he is not made subject to proceedings under Title IX." *Id.* (quoting 116 CONG. REC. 607 (1970)).

232. *Id.* (citing *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 492 n.10 (1985)); see also *supra* note 119 (discussing the Court's directive in *Sedima* to liberally construe RICO pursuant to the liberal construction clause).

233. *Reves*, 113 S. Ct. at 1172.

234. *Id.* at 1172 (stating that the purpose of the clause is "to ensure that Congress' intent is not frustrated by an overly narrow reading of the statute, but it is not an invitation to apply RICO to new purposes that Congress never intended").

235. *Id.* at 1174.

236. *Id.*; see also *supra* notes 39-52 and accompanying text (discussing Arthur Young's involvement with the Co-op).

237. *Id.* at 1173. The dissent argued that "financial statements are management's responsibility." *Id.* at 1176 (quoting the Code of Professional Conduct developed by the American Institute of Certified Public Accountants (AICPA)).

238. *Reves*, 113 S. Ct. at 1173-74.

239. *Id.* at 1173.

B. *The Dissent*

In dissent, Justice Souter, joined by Justice White, rejected both the operation or management test and its application to Arthur Young's involvement in the Co-op.²⁴⁰ First, the dissent analyzed the word "conduct" and found that it is a term of breadth that is not restricted by an element of direction or control.²⁴¹ The dissent supported its conclusion by suggesting that when the term is used as a verb, its leadership or directive aspect is often obscured.²⁴² Rather, the breadth of the term, the dissent observed, is demonstrated by the context and structure of the full subsection.²⁴³ The dissent argued that the subsection's language is designed to include individuals "associated" with an enterprise, whose conduct may be "indirect."²⁴⁴ Therefore, the majority's restrictive use of the operation or management test precludes Congress's intent to reach sub-management level associates and indirect participants in the enterprise.²⁴⁵ The dissent rejected the majority's reliance on "congressional shorthand" in the legislative history, which referred to the term "operation" in regard to section 1962(c), because the references do not demonstrate that Congress intended to limit the subsection's application exclusively to those operating or managing an enterprise.²⁴⁶ Since statutory ambiguity exists, the dissent argued, the liberal construction clause should control the issue.²⁴⁷ The liberal construction clause mandates that the more inclusive definition of conduct should prevail, unlimited by an element of direction or control.²⁴⁸

Despite its rejection of the majority's statutory interpretation, the dissent considered the application of the operation or management test to Arthur Young's involvement with the Co-op.²⁴⁹ The dissent recognized

240. *Id.* at 1174 (Souter, J., dissenting).

241. *Id.* at 1175 (stating that the term has a "long arm, unlimited by any requirement to prove that the activity includes an element of direction").

242. *Id.* at 1174. As an example of this proposition, Justice Souter cites "an investigation is conducted by all those who take part in it." *Id.* (quoting 3 OXFORD ENGLISH DICTIONARY 691 (2d ed. 1989)) (emphasis omitted).

243. *Id.*

244. *Id.* at 1174-75.

245. *Id.* The dissent asserted that the full context of the term defeats the majority's restrictive interpretation of the intended meaning of the word "conduct." *Id.*

246. *Id.* at 1175 n.1. The dissent suggested that "operation" can mean both "carrying forward" or "carrying out" and thus, to import a control element is an overly restrictive interpretation of the subsection. *Id.*

247. *Id.* (stating that the clause is an "express admonition" to interpret RICO broadly and a mandate which the Court has recognized in the past) (citing *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 497-98 (1985)).

248. *Id.*

249. *Id.* at 1175.

that traditional auditing activity does not implicate RICO.²⁵⁰ However, the creation of financial statements, the dissent argued, is not traditional auditing activity.²⁵¹ It is a managerial function which triggers the RICO provisions.²⁵² According to the dissent, Arthur Young clearly departed from its role as an independent auditor by creating financial statements that were the responsibility of management.²⁵³ Arthur Young "crossed the line separating 'outside' auditors from 'inside' financial managers."²⁵⁴ The dissent found that Arthur Young used its position to adopt a "blatant fiction" by concluding that the Co-op owned the gasohol plant on the date that construction commenced, when in fact a court decree indicated that the plant was acquired in 1980.²⁵⁵ Thus, Arthur Young fraudulently maintained the appearance of the Co-op's solvency and did not share this information with the Co-op's board of directors.²⁵⁶ On the basis of these facts, the dissent concluded that RICO liability is appropriate.

IV. THE LEGITIMACY OF THE OPERATION OR MANAGEMENT TEST

The Supreme Court in *Reves* correctly interpreted section 1962(c) to require a defendant to participate in either the operation or management of the enterprise's affairs.²⁵⁷ Given the alternative of an expansive articu-

250. *Id.* The dissent observed that traditional auditing activity is limited to the expression of an "opinion on [the client's] financial statements." *Id.* at 1176 (citing the Code of Professional Conduct developed by AICPA).

251. *Id.* at 1175.

252. *Id.* at 1175-76. This distinction is described by the auditors code:

"[T]he financial statements are management's responsibility. The auditor's responsibility is to express an opinion on the financial statements. Management is responsible for adopting sound accounting policies and for establishing and maintaining an internal control structure that will, among other things, record, process, summarize, and report financial data that is consistent with management's assertions embodied in the financial statements. . . . The independent auditor may make suggestions about the form or content of the financial statements or draft them, in whole or in part, based on information from management's accounting system."

Id. at 1176 (quoting CODIFICATION OF ACCOUNTING STANDARDS AND PROCEDURES, Statement on Auditing Standards No. 1 § 110.02 (AICPA) (1982)).

253. *Id.* at 1178-80. The dissent rejected the majority's contention that Arthur Young relied on White Flame's 1980 financial statements, which were prepared by the Co-op's previous accountants who were convicted of tax fraud, in valuing the gasohol plant. *Id.* at 1167, 1176. Although Arthur Young had questions regarding the valuation, it did not consult management, and it essentially "invented" the cost figure of the gasohol plant. *Id.* at 1176.

254. *Id.* at 1178.

255. *Id.* at 1177 n.5; see also *supra* notes 39-47 (discussing Arthur Young's valuation of the gasohol plant).

256. *Reves*, 113 S. Ct. at 1176-77.

257. See *infra* notes 259-92 and accompanying text (demonstrating that the operation or management test is supported by the statutory language, congressional intent, and pol-

lation of section 1962(c)'s participation requirement, the Court's adoption of a more stringent standard is both appropriate and necessary. The operation or management test is consistent with the plain language of the statute, the broad remedial purposes enunciated in the Act, and the Congressional intent set forth in the Act's legislative history.²⁵⁸ Moreover, *Reves* marks a necessary departure from the Court's perceived movement to adopt the more expansive interpretation of the RICO provision at issue.²⁵⁹ *Reves* also instructs that the liberal construction clause is not an invitation to apply RICO to situations unintended by its enactors.²⁶⁰ Finally, the operation or management test provides clarity and predictability to the statute by defining the contours of civil RICO liability in commercial disputes.²⁶¹

A. Consistency with RICO's Intent and Purpose

The operation or management test is consistent with RICO's broad remedial purposes and legislative history.²⁶² The majority in *Reves* recog-

icy); see also Brief for AICPA in Support of Respondent at 9, *Reves v. Ernst & Young*, 113 S. Ct. 1163 (1993) (No. 91-886). The Institute notes the significance of a proper interpretation and states:

This Court's well-founded expressions of concern regarding the use of RICO in garden-variety fraud cases and ordinary commercial disputes involving respected business persons and firms make it essential that section 1962(c)-RICO's most commonly invoked proscriptive provision be interpreted and applied in accordance with its plain language, legislative history and structure [which is consistent with an operation or management standard].

Id.

258. See *supra* note 265 (discussing the legislative history and Congress' indication to confine § 1962(c)'s application to persons operating, acquiring, or directing the RICO enterprise); see also Jed S. Rakoff, *Will the Supreme Court Come to Terms with RICO?*, N.Y. L.J., Sept. 10, 1992, at 3 (citing legislative statements in both the House and Senate which describe § 1962(c)'s intended application to individuals corruptly operating an enterprise and managers conducting the affairs of a business).

259. See *supra* note 95 (demonstrating the Supreme Court's historic and consistent reluctance to limit the application of RICO); see also *supra* note 37 (indicating that the departure from a liberal construction of RICO is perhaps limited to *Reves*).

260. See Ingber, Note, *supra* note 12, at S378 n.184 (stating that *Reves* is a seminal decision "because it represents one of the first times the Supreme Court has limited RICO's application by side-stepping RICO's 'liberal construction' clause which directs the Court to interpret RICO's provisions liberally"). Although *Reves* directly addressed the issue, the Supreme Court rejected the notion that the liberal construction clause can be invoked to apply RICO to situations unintended by Congress. *Reves v. Ernst & Young*, 113 S. Ct. 1163, 1172 (1993).

261. See AICPA Brief at 25-30, *Reves* (No. 91-886) (asserting that the operation or management test will clarify civil RICO's boundaries and will address essential policy concerns "raised by an expansive view of RICO liability").

262. See *infra* notes 265-67 (demonstrating that RICO application is consistent with RICO's legislative history). Ironically, most RICO actions are private, civil cases, yet Con-

nized that Congress understood the substantive provisions of section 1962(c) to require a heightened level of participation.²⁶³ The numerous references in the legislative history to the operation and management of an enterprise through a pattern of racketeering activity reflect this understanding.²⁶⁴ While these references are not dispositive,²⁶⁵ the operation or management test is consistent with the plain language Congress chose to define section 1962(c)'s substantive provisions.²⁶⁶

The Supreme Court has instructed courts to begin their analyses by examining the language of the statute to interpret RICO's provisions.²⁶⁷ A more expansive interpretation of the participation requirement would eliminate the term "conduct" from the provision.²⁶⁸ While the operation or management test restricts the scope of activity subject to RICO liability, it is broad enough to embrace a wide range of criminal conduct in

gress passed RICO's private remedy with little to no debate. In *Sedima*, the Second Circuit stated:

The legislative history of the Organized Crime Control Act of 1970 gives little hint of the intended scope of private action under civil RICO. . . . The decision to add a civil private damages provision was made by a House subcommittee at the behest of Representative Sam Steiger and the American Bar Association. The addition was not considered an important one, a remarkable fact which in itself indicates that Congress did not intend the section to have the extraordinary impact claimed for it. Indeed, when the Judiciary Committee initially introduced the amended bill, it did not even announce to the House that it had made the addition.

Sedima, S.P.R.L. v. Imrex Co., 741 F.2d 482, 489-90 (2d Cir. 1984) (footnotes omitted), *rev'd* 473 U.S. 479 (1985).

263. *Reves*, 113 S. Ct. at 1170.

264. *Id.* (discussing the legislative debates on RICO and finding that the enactors consistently discussed § 1962(c) as applying to those individuals operating or managing an enterprise through a pattern of racketeering activity); *see also* *United States v. Mandel*, 591 F.2d 1347, 1375 (4th Cir. 1979) (reviewing the legislative history of the Act and noting "the repeated use of the word 'operation' in describing the purpose of § 1962(c)"), *cert. denied*, 445 U.S. 961 (1980).

265. *United States v. Turkette*, 452 U.S. 576, 591 (1981) (indicating that it is improper to make a negative inference from congressional statements in the legislative history that limit the activities embraced by RICO).

266. *See supra* notes 213-27 and accompanying text (discussing the majority's analysis of the text of § 1962(c) and its compatibility with the operation or management test).

267. *Sedima*, 473 U.S. at 497-98; *Russello v. United States*, 464 U.S. 16, 20 (1983) (instructing that "[i]n determining the scope of a statute, we look first to its language. If the statutory language is unambiguous, in the absence 'of a clearly expressed legislative intent to the contrary, that language must ordinarily be regarded as conclusive.'") (quoting *Turkette*, 452 U.S. at 580).

268. *See supra* note 177 and accompanying text (criticizing the Eleventh Circuit's formulation of § 1962(c)'s participation standard, which merely required the defendant's activities to be necessary or helpful to the operation of the enterprise).

addition to the criminal activities of individuals inside the enterprise.²⁶⁹ Individuals outside the enterprise are included so long as their activities are significant enough to direct the affairs of the business.²⁷⁰ Arguably, *Sedima*'s²⁷¹ instruction to interpret RICO broadly,²⁷² despite reservations that RICO is embracing unintended situations,²⁷³ is inconsistent with *Reves*' more restrictive interpretation of conduct.²⁷⁴ However, as *Reves* suggests, the liberal construction clause may not be invoked to apply RICO to situations not contemplated by Congress.²⁷⁵

Courts and commentators have argued about precisely which situations Congress contemplated as being within the purview of civil RICO.²⁷⁶ This is perhaps the heart of the RICO debate. Despite this uncertainty, there are many persuasive policy arguments in favor of a more restrictive interpretation of section 1962(c), particularly in the context of professional service activities, such as the accounting industry.²⁷⁷ Professionals have experienced a liability crisis in which they have become the "insurer[s] of last resort" for investors of failed businesses.²⁷⁸ As a result, independent professionals can potentially incur a level of damages

269. *Reves v. Ernst & Young*, 113 S. Ct. 1163, 1173 (1993) (stating that outsiders will be liable under section 1963(c) "if they are 'associated with' an enterprise and participate in the conduct of its affairs") (emphasis omitted).

270. *Id.* at 1172-73.

271. 473 U.S. 479 (1985).

272. *See supra* note 119 (discussing the Supreme Court's perceived mandate to interpret RICO broadly).

273. *Sedima*, 473 U.S. at 499 (conceding "[t]he fact that RICO has been applied to situations not expressly anticipated by Congress' ") (quoting *Haroco, Inc. v. American Nat'l Bank & Trust Co.*, 747 F.2d 384, 398 (7th Cir. 1984), *aff'd*, 473 U.S. 606 (1985)); *see also supra* notes 13-16 and accompanying text (discussing the fact that RICO's application to garden-variety fraud and ordinary commercial disputes distorts Congress' original legislative intent to combat organized criminal behavior).

274. *Compare Sedima*, 473 U.S. at 498 (stating that the congressional directive to interpret RICO liberally is mandatory) *with Reves*, 113 S. Ct. at 1172 (stating that the liberal construction clause is only appropriate in the event of ambiguity and is not an invitation to apply RICO in contexts unintended by Congress).

275. *Reves*, 113 S. Ct. at 1172.

276. *See supra* notes 10-16 and accompanying text (discussing civil RICO and the debate over whether Congress intended to limit RICO's application to activities traditionally associated with organized crime, or to extend RICO to cover a much broader range of conduct).

277. *See McDonough*, Note, *supra* note 20, at 1109-10 (discussing the accounting industry's protest to its susceptibility to RICO prosecutions in light of the congressional intent to prosecute members of organized crime). Moreover, the author observes that "accounting firms that profess to be guilty of nothing worse than regrettable credulity in their client dealings, have increasingly found themselves the targets of the same sort of financial and public relations abuse that known mobsters must endure." *Id.* at 1110 n.15 (quoting Joe Queenan, *RICO Strikes Again! A Growing List of Businesses are Hit by Racketeering Charges*, BARRON'S Dec. 12, 1988, at 8, 20).

278. *McDonough*, Note, *supra* note 20, at 1107.

through traditional business fraud that is grossly in excess of their level of culpability in the commercial transaction.²⁷⁹ By imposing a heightened level of culpability to trigger RICO liability, professionals can perform their functions without the threat of unwarranted liability.²⁸⁰

Furthermore, the Supreme Court's adoption of the operation or management test does not inhibit RICO's potential ability to target other forms of serious and pervasive criminality. The operation or management test is consistent with prior applications of section 1962(c) despite the differences in the articulations of the participation requirement.²⁸¹ In *Scotto*,²⁸² for example, the defendant, as president of the local union and vice-president of the national union, accepted numerous bribes to direct the union to disregard violations of the collective bargaining agreement.²⁸³ He actively participated in the operation and management of the union's activities by directing the union's affairs.²⁸⁴ Similarly, in *Yarbrough*,²⁸⁵ the defendant participated in the operation or management of

279. Wright, *supra* note 12, at 994. The author argues that, by providing for treble damages, RICO has intensified the trend to target professionals for losses sustained as a result of fraud. *Id.* He states: "The imposition of disproportionate liability upon professionals has created a serious imbalance. People first in line for moral condemnation are ignored in the search for money. Peripheral figures and their insurance carriers become the exclusive sources of monetary recovery. The imbalance is real, not just theoretical." *Id.*

280. See Brief for AICPA in support of Respondent at 23-30, *Reves v. Ernst & Young*, 113 S. Ct. 1163 (1993) (No. 90-886). The Institute argued that an expansive interpretation of RICO liability induces extortionate litigation and coercive settlements, which threaten the accounting professional's ability and willingness to provide accounting services to smaller businesses and risky enterprises. *Id.* One author states:

Increased litigation against accountants by the victims of failed businesses has forced the industry to reevaluate its traditional function as public watchdog and curtail its auditing of financially troubled or "high risk" businesses . . . [which could result in] investors in "high risk" businesses not receiv[ing] necessary information about the most financially troubled public corporations.

McDonough, Note, *supra* note 20, at 1130 (footnote omitted); see Wright, *supra* note 12, at 995 (arguing that defining the contours of liability is necessary because "[t]he power to encourage proper conduct exists only if there is some benefit—i.e., freedom from exposure—from conformity. If an individual will be sued no matter what his conduct, what incentive is there to exercise care?").

281. Brodsky, *supra*, note 21, at 7 (indicating that prior decisions required at least as much direction as the test articulated in *Reves*).

282. *United States v. Scotto*, 641 F.2d 47 (2d Cir. 1980), *cert. denied*, 452 U.S. 961 (1981).

283. *Id.* at 50-52.

284. See *United States v. Provenzano*, 688 F.2d 194, 200 (3d Cir. 1982) (satisfying the operation or management test by accepting bribes as a manager in exchange for filing fewer worker compensation claims).

285. *United States v. Yarbrough*, 852 F.2d 1522 (9th Cir.), *cert. denied*, 488 U.S. 866 (1988).

the enterprise's affairs through his active membership and participation in both the racketeering activity and the RICO enterprise.²⁸⁶

In the context of professional services, *Reves*' operation or management test properly rejects the Eleventh Circuit's decision in *Bank of America*.²⁸⁷ *Bank of America* extended RICO liability to an accountant because he participated in services that were "necessary or helpful to the . . . enterprise."²⁸⁸ As the critics of that decision point out, RICO liability is based on more than just mere participation; rather, it is premised on participation in the management or direction of the enterprise's affairs.²⁸⁹ In contrast, the Second Circuit's decisions involving professional RICO liability are in accord with the operation or management test and correctly designate an element of direction as a prerequisite for liability under section 1962(c).²⁹⁰ As both the dissent and majority concede in *Reves*, the performance of traditional peripheral services will not rise to the level of directing an enterprise's affairs.²⁹¹ The more difficult issue, however, remains unresolved. Courts must still determine the point at which the fraudulent performance of peripheral services rises to a level of management or direction that will trigger RICO liability.

B. *Post-Reves Implications of the Operation or Management Test*

As a result of *Reves*, traditional auditing activity, although fraudulent, will correctly be outside of the scope RICO liability.²⁹² Furthermore, in-

286. *Id.* at 1544; see also *United States v. Cauble*, 706 F.2d 1322 (5th Cir. 1983), *cert. denied*, 465 U.S. 1005 (1984) (satisfying the operation or management test by directing a smuggling operation and providing the necessary money and property required to make it successful).

287. *Bank of Am. Nat'l Trust & Sav. Ass'n v. Touche Ross & Co.*, 782 F.2d 966 (11th Cir. 1986).

288. *Id.* at 970; see also *supra* notes 168-76 (discussing the Eleventh Circuit's standard).

289. See *supra* note 177 (criticizing the Eleventh Circuit's formulation of the participation standard).

290. See *Goldman v. McMahan, Brahman, Morgan & Co.*, 706 F. Supp. 256, 262 (S.D.N.Y. 1989) (noting that RICO liability will not attach where the predicate acts are unrelated to the enterprise or one's position in it); *Plains/Anadarko-P Ltd. Partnership v. Coopers & Lybrand*, 658 F. Supp. 238, 240 (S.D.N.Y. 1987) (finding that traditional auditing activity is not actionable under RICO).

291. *Reves v. Ernst & Young*, 113 S. Ct. 1163, 1174 (1993) (concluding that Arthur Young's concealment of information in its audit reports is not sufficient to impose RICO liability); *Id.* at 1175 (Souter, J., dissenting) (stating that "[i]f Arthur Young had confined himself in this case to the role traditionally performed by an outside auditor, I could agree with the majority that Arthur Young took no part in the management or operation of the Co-op").

292. See, e.g., *University of Md. at Baltimore v. Peat Marwick, Main & Co.*, 996 F.2d 1534 (3d Cir. 1993) (dismissing a RICO claim against a group of independent auditors who merely performed deficient financial services); *Nolte v. Pearson*, 994 F.2d 1311 (8th Cir. 1993) (affirming a directed verdict in favor of attorneys and accountants who gave tax

dependent professionals who perform services at the decisionmaking level, and induce a business to act in a certain manner, may not implicate RICO.²⁹³ The point at which an independent professional exerts influence over the enterprise or engages in the decisionmaking process should serve as the demarcation line between those professionals rendering truly independent services and those who are embroiled in the enterprise's affairs.²⁹⁴ At this level of involvement, the service-provider is participating in the management or operation of the enterprise, rather than its own business affairs.²⁹⁵ The trend to limit RICO liability to a more culpable class of fraud perpetrators, as confirmed by *Reves*, is likely to continue,

advice based solely on information provided by employees of an enterprise); *Gilmore v. Berg*, 820 F. Supp. 179 (D.N.J. 1993) (finding that an attorney who prepared false private placement memoranda regarding limited partnerships was not liable under RICO because he did not direct the legal entities he represented to engage in particular transactions).

293. See *Biofeedtrac, Inc. v. Kolinor Optical Enters. & Consultants, S.R.L.*, 832 F. Supp. 585 (E.D. N.Y. 1993) (holding that an attorney who provides legal advice and services to clients, in an effort to further the clients' schemes to defraud, does not violate RICO); *Fidelity Fed. Sav. & Loan Ass'n v. Felicetti*, 830 F. Supp. 257, 260 (E.D. Pa. 1993) (finding that "even where the wrongdoers provide misleading or fraudulent information which significantly influences a major decision of the enterprise, this still does not constitute 'operation or management' of the enterprise in order for 1962(c) liability to attach").

294. See, e.g., G. Robert Blakey, *The RICO Civil Fraud Action in Context: Reflections on Bennett v. Berg*, 58 NOTRE DAME L. REV. 237, 341-42 (1982). Professor Blakey discusses various types of fraud, such as commercial fraud, that should properly be subject to a private RICO action. *Id.* at 341 n.223. Recognizing that peripheral service providers may play a significant role in the commercial fraud that plagues the economy, Professor Blakey argues that it is not surprising such activities are subject to private civil relief. *Id.* at 341. He notes that "[o]rganized crime, for example, used 'accountants, attorneys and business consultants' to run its businesses." *Id.* at 341 n.223 (citing PRESIDENT'S COMMISSION ON LAW ENFORCEMENT AND ADMINISTRATION OF JUSTICE, *THE CHALLENGE OF CRIME IN A FREE SOCIETY* 189-91 (1967)). In addition, Professor Blakey describes the role of the professional in the fraudulent conduct:

[O]ur society . . . [has developed an] increasing dependency on the professional's specialized knowledge. Attorneys, accountants, and others play a key role in helping individuals and corporations conform to complex law and regulations. Because of new laws designed to combat organized criminal activity and expanded law enforcement investigative ability, organized crime figures . . . rely more on professional assistance. . . . [S]ome professionals misuse and violate the rules by helping known criminals to exploit the law. Professionals . . . act as direct consultants and advisors to organized crime groups for the purpose of assuring the success of criminal conspiracies.

Id. at 342 n.223 (citing TASK FORCE REPORT: ORGANIZED CRIME, PRESIDENT'S COMMISSION ON LAW ENFORCEMENT AND ADMINISTRATION OF JUSTICE 92 (1967)). This illustrates that a professional who has become embroiled in the enterprise's affairs is no longer acting in an independent capacity.

295. *Reves*, 113 S. Ct. at 1174. The majority stated, "[w]e need not decide in this case how far § 1962(c) extends down the ladder of operation." *Id.* at 1173 n.9. The Court did state, however, that an enterprise may be operated or managed by a lower level participant who exert[s] control over [the enterprise] or is "under the direction of upper management." *Id.* at 1173.

and will inhibit the application of RICO to professionals.²⁹⁶ Appropriately, this result will reduce and potentially eliminate the inexorable threat of treble damages for a class of defendants that is disproportionately liable for the damages resulting from traditional business fraud.²⁹⁷ A heightened standard of culpability may even mitigate civil RICO abuse by plaintiffs alleging violations predicated upon garden-variety fraud and ordinary commercial disputes.²⁹⁸ Moreover, *Reves*' judicial restriction of section 1962(c) will be welcomed by many who assert that existing federal laws effectively sanction these fraudulent practices,²⁹⁹ as well as those who maintain that courts should not displace existing laws by an overzealous use of civil RICO.³⁰⁰

296. See, e.g., Marcia Coyle, *RICO Limits Set for Professionals; Back to the Law's Intent?*, NAT'L L.J., Mar. 15, 1993, at 3 (stating that *Reves* marks the first significant limitation on civil RICO and "will limit abusive cases by limiting potential defendants to those actually running the enterprise, those inside and operating it," which will eliminate "outside professionals and third parties who may be deep pockets" as potential targets). However, § 1962(c) is only one of the mechanisms used to impose RICO liability. See *supra* notes 72-75 (discussing RICO's substantive provisions).

297. Wright, *supra* note 12, at 994.

298. Any limitation on civil RICO will be welcomed by many commentators. For a vociferous critique of civil RICO abuse, see L. Gordon Crovitz, *How the RICO Monster Mauled Wall Street*, 65 NOTRE DAME L. REV. 1050, 1068 (1990). The author states:

It is doubtful that Congress would ever pass a criminal law that equates criminal syndicates with legitimate businesses and private citizens. Certainly this is not what Congress envisioned in 1970 when it passed RICO. The question now is whether Congress will admit that its faulty drafting has led to untold injustices. RICO has led to coerced guilty pleas, which amount to legalized extortion. Out-of-court payments to settle civil suits are little more than classic shakedowns. Indeed, it is no exaggeration to conclude that until Congress finally repeals this outrageous statute or the Supreme Court invalidates it, RICO will remain the real racket.

Id. at 1068.

299. In *Reves*, for example, the jury found Arthur Young guilty of federal and state security law violations and assessed damages in the amount of \$6,121,652.94, which was not disturbed on appeal. *Arthur Young & Co. v. Reves*, 937 F.2d 1310, 1322 (8th Cir. 1991), *aff'd*, 113 S. Ct. 1163 (1993). See also TASK FORCE REPORT, *supra* note 9, at 55 (reporting that securities fraud accounted for 40% of civil RICO actions surveyed). Some commentators argue that civil RICO should be reformed to eliminate securities fraud as a RICO predicate because "Congress has considered directly the appropriate remedy for violation of the securities laws, and . . . it chose to limit such damages to actual damages." Getzendanner, *supra* note 8, at 683 (footnote omitted). Moreover, greater liability in the form of treble damages may contradict the goals of the federal securities laws by "deter[ring] legitimate enterprise, imped[ing] the raising of capital, and impos[ing] excessive litigation costs, costs that inevitably are borne by consumers and investors." *Id.* at 683-84 (quoting Daniel L. Goelzner, the General Counsel of the Securities and Exchange Commission).

300. The federal securities laws are perhaps the most frequently cited as displaced by civil RICO. See e.g., Crovitz, *supra* note 298, at 1055 ("[T]here is no evidence that Congress intended to replace the Securities Act[s] of 1933 and 1934 with RICO; fraud in the sale of securities by regulated brokers was already well covered by the criminal code.").

V. CONCLUSION

Reves marks a significant departure from traditional RICO jurisprudence. The Supreme Court's adoption of a restrictive interpretation of the participation requirement demonstrates that the Court, in this limited context, is not constrained by the congressional mandate to construe RICO liberally. The Court's approach suggests that it is willing to restrict RICO's breadth in the absence of congressional action. Despite its departure from prior judicial interpretations, the Court remains faithful to the statutory language and congressional intent. Independent professionals performing traditional peripheral services for a business should not be subject to civil RICO liability unless the significance of their involvement in the fraud can be demonstrated. Moreover, post-*Reves* restrictive applications of the operation or management test reveal a trend to further confine the participation requirement. This trend ultimately may eliminate professionals from the scope RICO liability. This result is appropriate because it places a necessary limitation on the use and application of the RICO statute against professionals who are disproportionately threatened by civil damages resulting from traditional business fraud. Other federal and state statutes will effectively target this conduct.

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Additionally, the author cites the Securities and Exchange Commission's view that it did not intend its decision to include securities fraud as a predicate act "to facilitate law enforcement against legitimate brokerages, but only against organized crime that used legitimate brokerages." *Id.* at 1055-56. Moreover, the author indicates that the SEC did not consider the possibility that RICO might contain a private remedy of treble damages for successful plaintiffs in securities fraud actions " 'which might in any way implicate or replace the traditional securities statutes.' " *Id.* at 1056.

